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BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman

GARY PIERCE
Commissioner

PAUL NEWMAN
Commissioner

SANDRA D. KENNEDY
Commissioner

BOB STUMP
Commissioner

Arizona Corporation Commission
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INVESTIGATION OF THE COST OF
TELECOMMUNICATIONS ACCESS.

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NOTICE OF FILING
INITIAL BRIEF OF VERIZON

Attached is the Initial Brief filed on behalf of Verizon Business Services and
Verizon Long Distance.

RESPECTFULLY SUBMITTED this 9th day of July, 2010.

LEWIS AND ROCA

Thomas H. Campbell
Michael T. Hallam
40 N. Central Avenue
Phoenix, Arizona 85004

Attorneys for Verizon

1 ORIGINAL and fifteen (15) copies
2 of the foregoing filed this 9th day of July, 2010, with:

3 Arizona Corporation Commission
4 Docket Control – Utilities Division
5 1200 W. Washington Street
6 Phoenix, Arizona 85007

7 COPY of the foregoing hand-delivered
8 this 9th day of July, 2010, to:

9 Jane L. Rodda
10 Administrative Law Judge
11 Arizona Corporation Commission
12 1200 West Washington Street
13 Phoenix, AZ 85007

14 Maureen Scott
15 Legal Division
16 ARIZONA CORPORATION COMMISSION
17 1200 West Washington Street
18 Phoenix, Arizona 85007

19 Mr. Steve Olea, Director
20 Utilities Division
21 ARIZONA CORPORATION COMMISSION
22 1200 West Washington Street
23 Phoenix, Arizona 85007

24 COPY of the foregoing mailed
25 this 9th day of July, 2010, to:

26 Norm Curtright
Qwest Corporation
20 East Thomas Road, 16th Floor
Phoenix, Arizona 85012

Reed Peterson
Qwest Corporation
20 East Thomas Road
16th Floor
Phoenix, Arizona 85012

Patrick J. Black
Fennemore Craig, PC
3003 N. Central Ave.
Suite 220
Phoenix, AZ 85012
Attorneys for Qwest Corporation
and Qwest Communications Company, LLC

1 Greg L. Rogers
2 Senior Corporate Counsel
3 Level 3 Communications, LLC
1025 Eldorado Boulevard
Broomfield, Colorado 80021

4 Paul Castaneda
5 President, Local 7019
6 COMMUNICATION WORKERS OF AMERICA
2501 W. Dunlap
Suite 103
Phoenix, AZ 85029

7
8 COPY of the foregoing e-mailed
this 9th day of July, 2010, to:

9 Dan Pozefsky, Chief Counsel
10 Residential Utility Consumer Office
11 1110 West Washington, Suite 220
Phoenix, AZ 85007
Dpozefsky@azruco.gov

12 Michael W. Patten
13 Roshka DeWulf & Patten, PLC
14 One Arizona Center
Phoenix, AZ 85004
mpatten@rdp-law.com

15 Michael M. Grant
16 Gallagher & Kennedy
2575 East Camelback Road
Phoenix, AZ 85016
mmg@gknet.com

18 Dan Foley
19 Isabelle Salgado
AT&T Nevada
645 E. Plumb Lane, B 132
PO Box 11010
Reno, NV 89520
dan.foley@att.com
gc1831@att.com

22 Joan S. Burke
23 Osborn Maledon, PA
24 2929 North Central Avenue, Suite 2 100
Phoenix, AZ 85012
jburke@omlaw.com

Lyndall Nipps
Vice President, Regulatory
Time Warner Telcom
845 Camino Sur
Palm Springs, CA 92262
Lyndall.Nipps@twtelecom.com

Rex Knowles
Executive Director - Regulatory
XO Communications
Suite 1000
111 E. Broadway
Salt Lake City, UT 84111
Rex.knowles@xo.com

Mark A. DiNunzio
Cox Arizona Telcom, LLC
1550 West Deer Valley Road
Phoenix, AZ 85027
MS DV3-16, Bldg C
mark.dinunzio@cox.com

Craig Marks
Craig A. Marks, PLC
10645 N. Tatum Blvd., Suite 200-676
Phoenix, AZ 85028
Craig.Marks@azbar.org

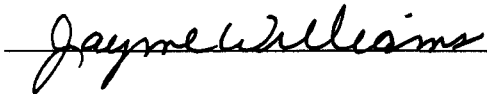
William A. Haas
Deputy General Counsel
McLeodUSA Telecommunications
Services, Inc.
6400 C. Street SW
Cedar Rapids, Iowa 52406
Bill.Haas@mcleodusa.com

1 Dennis D. Ahlers
2 Associate General Counsel
3 Integra Telecom, Inc.
4 730 Second Avenue, Suite 900
5 Minneapolis, MN 55402
6 ddahlers@eschelon.com

7 Charles H. Carrathers, III
8 General Counsel, South Central Region
9 Verizon, Inc.
10 HQE03H52
11 600 Hidden Ridge
12 Irving, Texas 750 15-2092
13 chuck.carrathers@verizon.com

14 Arizona Dialtone, Inc.
15 Thomas W. Bade, President
16 717 W. Oakland St.
17 Chandler, Arizona 85226
18 Tombade@arizonadialtone.com

19 Orbitcorn, Inc.
20 Brad VanLeur, President
21 1701 N. Louise Ave.
22 Sioux Falls, SD 57107
23 bvanleur@svtv.com

24
25
26


Arizona Payphone Association
c/o Gary Joseph
Sharenet Communications
4633 West Polk Street
Phoenix, Arizona 85043
garyj@nationalbrands.com

Karen E. Nally
Moyes, Sellers & Sims, Ltd.
1850 North Central Avenue, Suite 1100
Phoenix, AZ 85044
kenally@lawms.com

Nathan Glazier
Regional Manager
Alltel Communications, Inc.
4805 E. Thistle Landing Dr.
Phoenix, Arizona 85044
Nathan.glazier@alltel.com

Catherine A. Murray, Manager
Integra Telecom, Inc.
730 Second Avenue
Suite 900
Minneapolis, MN 55402
camurray@eschelon.com

W. John Hayes, General Manager
Table Top Telephone Company, Inc.
600 N. Second Ave.
Ajo, AZ 85321
jhayes@tabletoptelephone.com

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LEWIS AND ROCA

Thomas H. Campbell
Michael T. Hallam
40 N. Central Avenue
Phoenix, Arizona 85004

Attorneys for Verizon

Dated: July 9, 2010

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I. INTRODUCTION AND SUMMARY¹

Following an earlier examination of Qwest Corporation's ("Qwest's") intrastate switched access charges, the Commission initiated Phase II of Docket No. T-00000D-00-0672 to address the switched access charges of all other telephone companies in Arizona. On September 19, 2007, the Commission consolidated that proceeding with another docket that had been established to review and revise the Arizona Universal Service Fund ("AUSF") rules. After more "years of discussions [], discovery and workshops," the Commission concluded in October 2009 that "[t]here does not appear to be a dispute that access charges and AUSF should be reviewed to reflect the current realities in the communications industry."² The Commission decided that an evidentiary hearing would be the "best means" of moving forward and enabling the Commission to consider and make the necessary policy determinations regarding access charge reform and possible changes to the AUSF.³ Accordingly, a three-day hearing was held in March 2010 that focused on the specific issues the Commission deemed important to its investigation. The hearing produced a comprehensive record that provides the Commission with a solid evidentiary basis for implementing significant access reforms now.

The record demonstrates overwhelmingly that unreasonably high intrastate switched access rates harm competition and consumers, undermine economic efficiency, and are contrary to the public interest. While the solutions proposed by the various

¹ This brief is filed on behalf of Verizon Business Services and Verizon Long Distance (collectively "Verizon"), pursuant to the Procedural Order issued by the Administrative Law Judge on June 22, 2010. Verizon previously represented the interests of Verizon California in this proceeding, but the Arizona assets and local exchange operations of Verizon California were transferred to Frontier Communications Corp. on July 1, 2010, as authorized in Decision No. 71486 (Feb. 23, 2010).

² Procedural Order, issued October 1, 2009, at 3.

³ *Id.* at 4.

parties differ in certain respects, there is substantial agreement with the proposition that the intrastate switched access rates of most competitive local exchange carriers (“CLECs”) and rural incumbent local exchange carriers (“ILECs” or “RLECs”) in Arizona are excessive and should be reduced to more reasonable levels. Verizon’s recommendations for achieving specific access charge reforms can be implemented promptly and with minimal need for follow-on proceedings. The processes for implementing Verizon’s proposals are set forth in Section V below. At the very least, the Commission should move swiftly to lower CLECs’ access rates now, even if it finds additional steps are necessary before reducing ILEC access rates.

Verizon recommends that the Commission establish a rate cap for intrastate switched access services, and require all local exchange carriers (“LECs”), both CLECs and RLECs, to charge no more than the intrastate switched access rates of Qwest, the Regional Bell Operating Company (“RBOC”) in Arizona.

To the extent any LEC chooses not to absorb access price reductions, the Commission should allow the carrier to recoup any “foregone” access revenue through retail pricing flexibility. Because CLECs, as competitive carriers, already have sufficient retail pricing flexibility, they can make such adjustments immediately, without the need for any further proceedings. ILECs should be afforded similar pricing flexibility and given an opportunity to increase their retail local exchange rates up to an appropriate benchmark. Because the FCC and other state regulators have established similar price benchmarks for local exchange service, it should not be difficult or time-consuming for the Commission to set a benchmark for local service that is appropriate for Arizona. Accordingly, the implementation of access charge reform for ILECs could take place

soon after the conclusion of this proceeding.

LECs should no longer be permitted to recover a disproportionate amount of their costs from interexchange access customers, as has been the case for years. Instead, all carriers should be required to recover their appropriate costs, as well as any access revenues "lost" due to much-needed reform, from the customers of their retail services. Both CLECs and ILECs should be permitted to make "revenue neutral" changes to their retail rates without having to undergo rate cases, a "fair value" determination, or any other detailed review of their financial circumstances.

No carrier should be allowed to replace lost access revenues with funds obtained from an expanded AUSF. Indeed, the Commission should reject calls to expand the size or scope of the AUSF for this purpose, as doing so would be inconsistent with the original goals of the program and impose an improper financial burden on Arizona consumers. A subsidy is a subsidy, regardless of whether it takes the form of an excessive intrastate switched access rate or a mandatory contribution to an access recovery mechanism. Moreover, insulating one set of providers from competition at the cost of another is incompatible with a healthy, competitive market for communications services. Shifting the revenue burden from one carrier-funded source (access rates) to another (an expanded AUSF) does nothing to solve the fundamental problem that some carriers are collecting too great a portion of their operating revenues from other carriers, rather than their own end users.

Because it is not necessary to expand the AUSF to achieve intrastate switched access charge reform, the Commission can and should promptly adopt and implement policies that will rationalize intrastate access rates charged by all LECs in Arizona

without having to initiate additional proceedings to consider possible changes to the AUSF.

II. THERE IS SUBSTANTIAL CONSENSUS THAT INTRASTATE ACCESS CHARGE REFORM IS NEEDED IN ARIZONA

Switched access is an essential service: long-distance carriers cannot avoid using the switched access services of local exchange carriers. In the absence of market forces that drive access prices towards reasonable levels, many local exchange carriers in Arizona charge intrastate switched access rates that greatly exceed those of Qwest. The record demonstrates that excessive and disparate access rates in Arizona harm competition and consumers, distort investment decisions, and create incentives for improper arbitrage behavior. Reducing excessive access charges, on the other hand, will yield several important benefits, including more consistent and rational intrastate switched access rates, price efficiency, enhanced competition, and the reduction of arbitrage opportunities.

In light of these and other facts, there is substantial consensus that the long-standing access charge regime in Arizona is not sustainable in today's competitive market. As explained by Commission Staff, "[m]ost parties agree that switched access charges need to be reformed."⁴ Indeed, there is broad support for reform efforts across most segments of the industry. Interexchange carriers ("IXCs") and Qwest, the state's largest service provider, all support access charge reform. The Arizona Local Exchange Carriers Association ("ALECA"), which represents independent LECs, also testified that

⁴ Ex. S-1 (Shand Direct) at page 1 of Executive Summary.

intrastate switched access service reform “is in the public interest.”⁵ While ALECA expressed concerns regarding the opportunities its members would have to recover the revenues foregone due to intrastate access reform, it never disputed the need for and demonstrated benefits of access charge reform.

Verizon and AT&T – both of which have CLEC affiliates in Arizona – vigorously support access charge reform, even though their proposals will require their own CLECs to lower their intrastate access rates.⁶ Other CLECs⁷ dispute the necessity for access charge reform, although their primary objective appears to be one of delaying inevitable reforms, either by waiting until the Federal Communications Commission (“FCC”) completes a number of anticipated rulemakings,⁸ or by stringing out any such reforms in Arizona as long as possible, *i.e.*, by up to 8 or 10 years.⁹ As will be shown below, these CLECs’ objections to access reform lack merit and their arguments are contradicted by the evidentiary record. Accordingly, their pleas to delay needed reforms should be rejected, and the Commission should move swiftly to reduce excessive intrastate switched access rates.

⁵ Ex. ALECA-1 (Meredith Direct) at 6.

⁶ Ex. VZ-2 (Price Reply) at 13; Tr. at 391, 415; Ex. AT&T-9 (Oyefusi Reply) at 5; Ex. AT&T-3 (Aron Reply) at 7, 40.

⁷ References herein to “CLEC” parties are to Eschelon Telecom of Arizona, Inc.; Mountain Telecommunications, Inc.; Electric Lightwave, LLC; McLeodUSA Telecommunications Services, Inc. d/b/a PAETEC Business Services; tw telecom of Arizona llc; and XO Communications Services, Inc. (collectively, the “Joint CLECs”) and Cox Arizona Telcom, L.L.C. (“Cox”), and are not intended to encompass the views of Verizon’s and AT&T’s CLEC affiliates.

⁸ Ex. Cox-1 (Garrett Direct) at 5. Cox expresses its belief that over a relatively long period, all intercarrier compensation rates, including access charges, “should be unified and reduced to zero or ‘bill and keep.’” *Id.* at 8.

⁹ Ex. JCLEC-1 (Denney Direct) at 13, 52; Ex. JCLEC-2 (Denney Reply at 5).

III. THE COMMISSION SHOULD IMMEDIATELY CAP CLEC SWITCHED ACCESS RATES, AND REQUIRE CLECS TO REDUCE THEIR RATES TO THE LEVEL OF QWEST'S INTRASTATE RATE

The intrastate switched access rates of many CLECs are excessive and unreasonable. Because market forces are not sufficient to discipline their rates, regulatory intervention is required. Reducing CLEC access rates to the level of Qwest's intrastate rate will produce many important public benefits.

A. Market Forces Do Not Discipline the CLECs' Access Rates

While CLECs are not perceived as possessing market power for retail services, they do hold such power in the market for switched access service.¹⁰ Other carriers have no choice but to use a CLEC's switched access services when they handle interexchange calls originating from the CLEC's customers and when they deliver interexchange calls for termination to the CLEC's customers.¹¹ A toll provider cannot refuse to deliver a call to a CLEC's end user,¹² and thus cannot avoid the terminating access charges of CLECs, whose access charges have never been subject to regulatory scrutiny.

The Joint CLECs acknowledge that even after Qwest reduced its intrastate access rates on four occasions since 2001, they made no corresponding rate reductions because

¹⁰ Ex. Q-1 (Eckert Direct) at 9, 5; Ex. Sprint-1 (Appleby Direct) at 4 (“[s]witched access is a monopoly service”); Ex. Sprint-3 (Appleby Reply) at 8; Ex. VZ-4 (Price Direct) at 8-9; Ex. AT&T-1 (Aron Direct) at 86-87; Tr. at 316-317; Tr. at 66-67.

¹¹ Ex. VZ-4 (Price Direct) at 8-9; Ex. VZ-2 (Price Reply at 4); Ex. S-1 (Shand Direct) at 9 (“With respect to termination of a call to a CLECs' customers, the IXC's have no alternative but to pay the CLECs' rates to terminate calls.”); Ex. Sprint-3 (Appleby Reply) at 8 (“The CLEC is a monopoly provider of terminating access functionality on a call by call basis.”); Ex. Q-1 (Eckert Direct) at 5.

¹² As a general rule, common carriers are legally obligated to complete calls to any end users that their customers desire to call, including end users of CLECs with unreasonably high access rates. The FCC has ruled that “no carriers, including interexchange carriers, may block, choke, reduce or restrict traffic in any way.” *Establishing Just and Reasonable Rates for Local Exchange Carriers and Call Blocking by Carriers*, WC Docket No. 07-135, Declaratory Ruling and Order, DA 07-2863 (June 28, 2007) at ¶ 6.

“there was no reason” to do so.¹³ If nothing else, this is a tacit admission of the CLECs’ market power, and an express acknowledgment that market forces in Arizona have failed to discipline their access rates. As explained by AT&T witness Dr. Aron:

If a CLEC competed with the ILEC in the provision of a particular service, there would be downward pressure on its price if the ILEC lowered its own price. If the CLEC has no market power, its prices for switched access service would not be expected to exceed the ILEC’s rate in its geographic area *even if it has higher costs*, because customers would not choose to purchase a comparable service at a higher price if they had a choice. The fact that CLECs have sustained higher prices than Qwest and felt “no reason” (in Mr. Denney’s words) to respond to Qwest’s lower prices by decreasing their own switched access rates is because Qwest’s intrastate switched access service does not compete with the CLECs’ switched access services and vice versa—i.e., the CLECs possess market power with respect to switched access service.¹⁴

Significantly, the Joint CLECs do not contest the fact that they have market power with respect to terminating switched access. They claim instead that the “CLEC ‘monopoly’ argument is not supported by the parties with respect to originating access,” and that any access charge reform should, accordingly, be limited to terminating rates.¹⁵ The Commission cannot take this contention seriously, given that it is not supported by the record and has been rejected by the FCC and other state regulatory agencies that have examined the market for CLEC access service.

1. The Record Demonstrates that CLECs Have Market Power for Originating Access Service

Witnesses for both Verizon and AT&T emphasized that the CLECs’ market

¹³ Ex. JCLEC-1 (Denney Direct) at 20.

¹⁴ Ex. AT&T-3 (Aron Reply) at 23 (emphasis in original); *see also* Ex. Sprint-3 (Appleby Reply) at 8.

¹⁵ Ex. JCLEC-2 (Denney Reply) at 5.

power exists for *both* originating *and* terminating switched access service.¹⁶ A review of intrastate tariff rates presented by AT&T witness Dr. Aron shows that the originating access rates in the Joint CLECs' tariffs in Arizona consistently exceed those of Qwest - by as much as 46% to 98%.¹⁷ Based on her analysis of these CLEC tariff rates, Dr. Aron concluded "there is significant market power in originating access."¹⁸

Providing additional specificity, AT&T witness Dr. Oyefusi explained that once an IXC's end user chooses a particular CLEC for local service, the IXC must accept that end user's long distance calls and pay that CLEC's originating access charges.¹⁹ The IXC cannot block calls, and cannot forbid its end users from choosing a particular CLEC for local service. And, because of geographic averaging requirements, an IXC cannot charge higher rates to end users that use a particular CLEC for local phone service, which might encourage end users to either choose a different and less expensive local carrier or make fewer calls.²⁰ Because of these circumstances, consumers do not receive correct price signals, are not aware of the true cost of the service they receive, and select a CLEC without knowing that their decision causes their long distance provider to pay the CLEC's excessive access charges.

¹⁶ Ex. VZ-4 (Price Direct) at 8; Ex. VZ-2 (Price Reply) at 10-12; Ex. VZ-3 (Price Rejoinder) at 2-3; Ex. AT&T-1 (Aron Direct) at 86-87; Ex. AT&T-3 (Aron Reply) at 12-19; Ex. AT&T-4 (Aron Rejoinder) at 24-26; Ex. Q-5 (Eckert Rejoinder) at 6-8.

¹⁷ See Ex. AT&T-4 (Aron Rejoinder) at 24-25, Figure 1.

¹⁸ See also Tr. at 67 (RUCO witness Dr. Johnson: "So I do agree that CLECs, with respect to their particular customers, have some degree of power over the pricing of the charges that they impose on other carriers when those other carriers interconnect and want to *receive calls from or send calls to* that CLEC's local customers.") (emphasis added).

¹⁹ Ex. AT&T-7 (Oyefusi Direct) at 23.

²⁰ Ex. AT&T-11 (Oyefusi Rejoinder) at 7-8. Dr. Oyefusi also asserted that even if there were no legal requirement for IXCs to geographically average their long distance prices, there are practical and pro-consumer reasons for doing so. For example, it would be "nearly impossible for IXCs to create and then maintain billing systems that charge different retail prices based on the virtually infinite possible combination of LECs that the end users at each end of every possible call might choose - and then update those prices every time any LEC changes its access rates." *Id.* at 8.

2. Other Regulatory Agencies Have Found That CLECs Have Market Power Over Originating Access Service

When the FCC imposed a cap on CLEC interstate access charges, it observed that the market for CLEC switched access services “does not appear to be *structured* in a manner that allows competition to discipline rates.”²¹ In reaching that conclusion, the FCC found that “CLEC originating access service may also be subject to little competitive pressure, notwithstanding the fact that the IXCs typically have a relationship with the local exchange provider in order to be included on the LEC’s list of presubscribed IXCs.”²² The FCC found “ample evidence that the combination of the market’s failure to constrain CLEC access rates, our geographic rate averaging rules for IXCs, the absence of effective limits on CLEC rates and the tariff system create an arbitrage opportunity for CLECs to charge unreasonable access rates.”²³

The FCC’s conclusion that CLECs’ access rates are not disciplined by competition expressly applies to *both* terminating *and* originating access. As a result, the FCC’s price cap rule applies to both the originating and terminating interstate switched access rates of CLECs. While the Joint CLECs quibble with the applicability of the factors relied upon by the FCC in its decision,²⁴ they ignore the fact that the FCC has not withdrawn, reversed or altered its 2001 conclusion that originating access is a monopoly service, including when its chairman proposed to revamp the intercarrier compensation

²¹ *Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923 (2001) (“*CLEC Rate Cap Order*”) at ¶ 32 (emphasis in original).

²² *Id.* at ¶ 29.

²³ *Id.* at ¶ 34.

²⁴ *See* Ex. JCLEC-2 (Denney Reply) at 8-10, 14.

system in 2008,²⁵ or in the intrastate switched access reform provisions of the National Broadband Plan (“NBP”) it announced in March of this year.

Last year, the Massachusetts Department of Telecommunications and Cable (“DTC”) also found market failures in both the originating and terminating CLEC switched access markets.²⁶ After examining the market for both services, the DTC concluded that “the originating switched access market also is not sufficiently competitive” and that “the failure of existing competitive forces to discipline rates results in CLECs having market power” with respect to originating access.²⁷ The DTC reviewed “the structural deficiencies” that the FCC found inhibit market forces in the interstate switched access market, and concluded that those same conditions “*similarly inhibit competition in the intrastate originating switched access market among CLECs.*”²⁸ For these reasons, the Massachusetts DTC imposed a cap on both originating and terminating access rates of CLECs.

3. The Joint CLECs’ Attempts to Minimize the Reality of their Market Power Are Unpersuasive

The Joint CLECs try to downplay the substantial record evidence regarding the nature and extent of CLEC market power by asserting that “CLECs do not have the market power to *increase rates as much as they can.*”²⁹ However, the fact that a CLEC may have refrained from tariffing “significantly higher” rates, as suggested by the Joint

²⁵ See Ex. VZ-3 (Price Rejoinder) at 5; Ex. AT&T-4 (Aron Rejoinder) at 26-27.

²⁶ *Petition of Verizon New England Inc. et al. for Investigation Under Chapter 159, Section 14, of the Intrastate Access Rates of Competitive Local Exchange Carriers*, Final Order, D.T.C. 07-9 (June 22, 2009) (“*Massachusetts DTC Order*”); reconsideration denied (Dec. 7, 2009).

²⁷ *Id.* at 14, 17.

²⁸ *Id.* at 17 (emphasis added).

²⁹ Ex. JCLEC-2 (Denney Reply) at 12 (emphasis in original).

CLECs' witness,³⁰ is not sufficient to negate the existence of the carrier's market power. There are many reasons why a CLEC may decide not to set a much higher rate, such as a desire to obtain Commission approval of its tariff prior to being able to offer service.³¹

The Joint CLECs make two additional arguments in an attempt to dispute the fact that IXC's do not have a choice of an access provider when they originate a long distance call. But neither argument undermines the substantial record evidence that CLECs possess market power in the case of originating access.

The Joint CLECs first claim that, because the local exchange market is open to competition, an IXC can control its access costs by acquiring the CLEC's end user as a local customer.³² The initial flaw in this argument is that it is predicated on the erroneous assumption that all IXC's also operate as CLECs and offer local exchange service in addition to interexchange service, a presumption that is flatly incorrect. Moreover, there is no factual basis for the suggestion that the process of customer acquisition and the threat of *retail* competition will force CLECs to lower their *intrastate switched access rates*. As Verizon's witness Mr. Price testified:

The notion that competition for retail end users will discipline CLECs' access rates over time ignores the marketplace reality that carriers compete

³⁰ *Id.* at 10.

³¹ See Ex. AT&T-4 (Aron Rejoinder) at 27.

³² Ex. JCLEC-2 (Denney Reply) at 13. In his rejoinder testimony, Mr. Denney opined that an IXC could control access costs through its "ability to self provision access," by purchasing special access facilities. Ex. JLEC-3 (Denney Rejoinder) at 12-13. However, he failed to demonstrate that such "bypass alternatives" are feasible for residential or small business customers, or a viable option for all of an IXC's large business customers. See, e.g., Tr. at 497-498. Once a CLEC's local service customer selects an IXC to handle its long distance traffic, it would make no sense for every other IXC in Arizona to establish special access connections to that end user simply in order to avoid the CLEC's high terminating switched access rates when they complete long distance calls to that end user. In addition, Mr. Denney's suggestion that "[i]f the cost of bypass alternatives were to significantly decrease, then there would be additional pressure on LECs to reduce access rates in order to compete with this alternative" was purely speculative about what *might* occur in the future, and not predicated on current market conditions. See Ex. JCLEC-3 (Denney Rejoinder) at 13 (emphasis added).

with each other for customers by offering the best *retail* price for a service. End users care only about what they have to pay their chosen supplier, not what that supplier may be charging others for upstream services such as switched access. In other words, carriers compete for end-user customers on the basis of retail rates, not switched access rates. In fact, if a CLEC lowers its retail rates to compete in the retail market, it has the incentive to maintain high switched access rates to make up for retail revenues lost from aggressively lowering its retail rates to win a customer.³³

Thus, Mr. Denney's contention that competition for end users acts as a constraint on switched access rates is demonstrably at odds with marketplace realities. Moreover, taking the Joint CLECs' argument to its logical conclusion, the only way an IXC could stop paying inflated switched access rates to a particular CLEC would be to compete so aggressively against that CLEC in the retail market that the CLEC loses all of its customers and is driven out of business. The implication that a retail monopoly is the only way to eliminate high access charges is illogical and unsound.³⁴

The Joint CLECs also argue that an IXC has the ability to set long distance prices for its customers by taking into account the cost of originating access. According to their witness, end users look at their total communications cost when selecting a local carrier, and if a CLEC were to set originating access charges too high it would risk losing its customers because they would seek a carrier that can provide better overall pricing.³⁵ But this argument ignores the marketplace realities described above, as well as the fact that IXCs are required to geographically average their rates for long distance service.³⁶

Because an IXC must charge all end users the same rates regardless of which CLEC the

³³ Ex. VZ-3 (Price Rejoinder) at 4 (emphasis in original).

³⁴ *Id.* at 5.

³⁵ Ex. JCLEC-2 (Denney Reply) at 8.

³⁶ See Ex. AT&T-3 (Aron Reply) at 15-16, 18-19; see also Ex. AT&T-7 (Oyefusi Direct) at 21, 23; Ex. AT&T-11 (Oyefusi Rejoinder) at 7-9 (asserting that 47 U.S.C. § 254(g) requires geographic rate averaging for intrastate and interstate interexchange services).

end user subscribes to and regardless of how high a particular CLEC's access rates might be, the FCC found that "IXCs have little or no ability to create incentives for their customers to choose CLECs with low access charges."³⁷ And, rejecting the point the Joint CLECs make here, the FCC concluded that because IXCs are unable to pass through access charges to their end users, an end user that chooses a high-priced LEC "has no incentive to minimize costs. Accordingly, CLECs can impose high access rates without creating the incentive for the end user to shop for a lower-priced access provider."³⁸

The Massachusetts DTC evaluated this same issue from an intrastate perspective in its decision discussed above. The DTC noted that in the case of originating CLEC access, the calling party is the cost-causer and "could, theoretically, react in response to high origination prices" if an IXC tried to pass through the actual cost of switched access.³⁹ However, it found that because geographic averaging spreads high access rates across all of an IXC's customers, geographic averaging "masks the price signals of high originating access charges from the callers causing them."⁴⁰ Interexchange carriers are legally precluded from geographically deaveraging their interstate toll rates, and the DTC concluded it would not be "practicable" to implement rate deaveraging of intrastate toll calls.⁴¹ The DTC found that trying to do so would be "unnecessarily burdensome" and "add undue expense and complication to carriers' billing systems." It also explained that the new complex billing format would be confusing to consumers and require a

³⁷ *CLEC Rate Cap Order* at ¶ 31.

³⁸ *Id.*

³⁹ *Massachusetts DTC Order* at 14.

⁴⁰ *Id.* at 15.

⁴¹ *Id.* at 16.

“cumbersome education effort.”⁴² Thus, contrary to the Joint CLECs’ position here, the DTC found there are no practical means of stimulating competition in the originating access market that would overcome the CLECs’ market power over switched access service. Its analysis is equally applicable here in Arizona.

B. The Intrastate Switched Access Rates of Many CLECs in Arizona Greatly Exceed Qwest’s, and Are Thus Unreasonable

Having reduced its intrastate access rates four times since 2001,⁴³ Qwest’s current composite rate is 2.2 cents per minute.⁴⁴ Many CLECs in Arizona charge intrastate access rates that are substantially higher than that amount. Qwest testified that some CLECs charge as much as 5.7 cents per minute in Arizona - “more than twice the rate charged by Qwest.”⁴⁵ Data initially presented by AT&T witness Dr. Aron show that the “average” intrastate per minute rate of the CLECs she examined is nearly 40% higher than Qwest’s charge for the similar service.⁴⁶ Relying on information obtained in discovery, Dr. Oyefusi testified in a later round that the differential is much greater.⁴⁷

Significantly, the CLECs do not dispute the fact that their access rates typically are much higher than Qwest’s intrastate rate. On the contrary, the Joint CLECs’ own data show that their originating and terminating switched access charges are substantially higher than Qwest’s *current* intrastate rates.⁴⁸ Their witness testified that “the Joint

⁴² *Id.*; see also Ex. AT&T-11 (Oyefusi Rejoinder) at 8.

⁴³ Ex. Q-1 (Eckert Direct) at 3 (stating that the total amount of the reductions was \$27 million).

⁴⁴ Ex. ALECA-1 (Meredith Direct) at 7; Ex. ALECA-2 (Meredith Reply) at 4.

⁴⁵ Ex. Q-1 (Eckert Direct) at 6.

⁴⁶ Ex. AT&T-2 (Aron Direct) at 39, HIGHLY CONFIDENTIAL Table 2.

⁴⁷ Ex. AT&T-9 (Oyefusi Reply) at 23-24. See also Ex. AT&T-4 (Aron Rejoinder) at 6.

⁴⁸ Ex. JCLEC-1 (Denney Direct) at 19; Ex. JCLEC-2 (Denney Reply) at 2; see also Ex. AT&T-3 (Aron Reply) at 23 (using the Joint CLECs’ methodology shows that current CLEC rates are “well over double” the average intrastate access rates charged by Qwest).

CLECs' composite terminating access rates are in the vicinity of 4 to 5 cents" per minute,⁴⁹ which is roughly double Qwest's rate of 2.2 cents per minute. While the Joint CLECs provided a comparison of CLECs' current tariff rates with Qwest's rates in effect 11 years ago (the relevance of which is discussed below), the CLEC rates they depict are consistent with Dr. Aron's presentation which shows that most CLEC intrastate rates greatly exceed those of Qwest. According to her testimony, "[a]s long as CLECs have market power in the provision of access services, and their rates are demonstrably above those of the ILECs with whom they compete, their rates are not just and reasonable from an economic standpoint."⁵⁰

C. There Is No Reasonable Basis for Arizona CLECs to Charge Intrastate Access Rates Higher than Qwest's

Historically, in order to promote universal service goals, regulators purposefully set the access charges of local exchange carriers at artificially high levels to keep basic exchange service rates for residential consumers low.⁵¹ However, the traditional policy rationale for that pricing approach, which tolerated implicit subsidies in access charges, does not apply to CLECs.

Competitive LECs began entering markets in the late 1990's without the legacy obligations of incumbent LECs and without traditional regulation of their rates, whether retail rates charged to end users or access rates charged to other carriers.⁵² These newer market entrants have no obligation to serve residential customers, let alone residential

⁴⁹ Ex. JCLEC-2 (Denney Reply) at 10.

⁵⁰ Ex. AT&T-3 (Aron Reply) at 24.

⁵¹ Ex. VZ-4 (Price Direct) at 6-7; Ex. Sprint-1 (Appleby Direct) at 4-6; Ex. AT&T-1 (Aron Direct) at 22-24; Ex. AT&T-7 (Oyefusi Direct) at 4, 16-17; Ex. Q-1 (Eckert Direct) at 2-4. Staff testified that the FCC has been steadily moving away from this traditional approach. Ex. S-1 (Shand Direct) at 4-6.

⁵² See Ex. VZ-4 (Price Direct) at 7, 10; Tr. at 399, 415.

customers in rural or other high-cost areas. Nor do they bear the historical legacy of having to maintain low, regulated retail prices for residential consumers throughout their service areas. The Joint CLECs admit that they can be selective in choosing which customers to serve with their assertion that “[m]ost of the CLECs focus on business markets, where customer acquisition is typically pro-active: CLEC’s sale representative calls potential end-users.”⁵³ The Joint CLECs thus essentially concede that public policies aimed at protecting residential consumers are not applicable to their business model. In fact, “[t]he historical justification for excessive access rates simply does not apply to CLECs because the public policy rationale was never to subsidize retail business services.”⁵⁴ Thus, none of the reasons used in the past to justify higher access rates for Qwest and other ILECs, including the inclusion of implicit subsidies in access rates, apply to CLECs in Arizona.

Having only entered the market relatively recently, CLECs also have had the opportunity to use the most efficient mix of technologies and network configurations possible. As a result, they should be able to operate at least as efficiently as the incumbent carriers with their legacy networks.⁵⁵ Accordingly, there is no reasonable basis for CLECs to charge higher access rates than the incumbents against which they compete.

D. Unreasonably High Switched Access Rates Harm Consumers and Competition, and Distort the Markets for Communication Services

Unreasonably high CLEC switched access rates distort the market for communication services, impair competition in Arizona and negate the consumer benefits

⁵³ Ex. JCLEC-2 (Denney Reply) at 13.

⁵⁴ Ex. AT&T-3 (Aron Reply) at 54.

⁵⁵ Ex. VZ-4 (Price Direct) at 10.

that competition was intended to bring.⁵⁶

CLECs that charge unreasonably high access rates obtain an inappropriate competitive advantage because they are able to recover disproportionately more of their costs from other carriers (*i.e.*, their competitors) than from their own end users through their retail rates. CLECs with high access rates are able to offer lower retail rates to their customers than they would be able to do if their access rates were properly constrained by regulation or market forces. By paying unreasonably high switched access rates to these CLECs, the purchasers of switched access services are forced to help fund the retail service offerings of their direct competitors in the same service areas.⁵⁷

This cost-shifting distorts competition in interexchange and other communications markets by, for example, imposing costs that must be passed on to the IXC's customers. Because the IXCs pay higher CLEC access rates than they should, they are forced to divert large sums away from their own operations to fund the CLECs' businesses, thereby depriving the carriers of resources they could otherwise use to introduce new services, improve service quality, enhance their networks, or even reduce rates – to the ultimate detriment of their customers.

The record also makes clear that excessive intrastate access rates create opportunities for arbitrage, as well as incentives for local exchange carriers to engage in access stimulation or "traffic pumping" schemes.⁵⁸ Under these arrangements, local exchange carriers enter into kickback arrangements with providers of "free" chat lines, conference calling, international calling and other services to artificially inflate call

⁵⁶ *Id.* at 9-10; Ex. Sprint-1 (Appleby Direct) at 3, 7-9; Ex. AT&T-3 (Aron Reply) at 4.

⁵⁷ Ex. VZ-4 (Price Direct) at 9-10; Ex. Sprint-1 (Appleby Direct) at 5.

⁵⁸ *Id.* at 78-81; Ex. AT&T-7 (Oyefusi Direct) at 45-46; Ex. S-1 (Shand Direct) at 9; Ex. ALECA-1 (Meredith Direct) at 6; Ex. Q-1 (Eckert Direct) at 5.

volumes. When switched access rates are priced unreasonably high, the increased traffic generated by the “free” services produces a substantial increase in the LEC’s switched access revenues. The LEC is willing to “share” a significant portion of its revenues with a third party only because the arrangement produces supra-competitive profits.⁵⁹ The testimony suggests that such schemes are beginning to appear in Arizona.⁶⁰

E. Access Charge Reform Will Yield Significant Public Benefits

A number of parties agree that Arizona’s access charge system, which continues to rely too much on implicit subsidies, is no longer sustainable.⁶¹ Reforming that regime will therefore mitigate, if not eliminate, the competitive and consumer harms described above.

For example, history shows that reducing switched access rates will result in consumers paying lower rates for long distance services.⁶² In this proceeding, Verizon and AT&T have already committed to eliminate certain retail charges once access charges are reduced in Arizona.⁶³ In addition, rationalizing rates will encourage investment that better reflects the relative efficiencies of different technologies and service providers.⁶⁴ Staff testified as well that reducing unreasonable access charges will produce several other important benefits, including price efficiency, reduced opportunities for arbitrage, the elimination of differences in rates that are the result of

⁵⁹ Tr. at 281-283, 458-459; *see also Qwest Communications Corp. v. Farmers and Merchants Mutual Telephone Co.*, FCC 09-103, Second Order on Reconsideration (File No. EB-07-MD-001) (Nov. 25, 2009).

⁶⁰ Tr. at 454.

⁶¹ Ex. Sprint-1 (Appleby Direct) at 5; Ex. Q-1 (Eckert Direct) at 4; Ex. AT&T-1 (Aron Direct) at 26-27.

⁶² Ex. AT&T-1 (Aron Direct) at 12, 58-65; Tr. at 345-346; Ex. AT&T-7 (Oyefusi Direct) at 40-41; *see also* Ex. ALECA-1 (Meredith Direct) at 12.

⁶³ Ex. VZ-2 (Price Reply) at 37 (expressing Verizon’s intent to eliminate an Instate Access Recovery Fee that is paid by certain residential customers); Ex. AT&T-7 (Oyefusi Direct) at 42 (pledging to reduce AT&T’s in-State Connection Fee that is charged to stand-alone long distance customers).

⁶⁴ *Id.* at 13.

historic regulatory decisions and distinctions, and the establishment of more consistent and rational intrastate switched access rates.⁶⁵

F. The Commission Should Establish a Uniform Rate Benchmark and Reduce CLECs' Access Rates to the Level of Qwest's Intrastate Access Rates

The record in this proceeding clearly establishes that the Commission cannot rely on market forces to assure just and reasonable CLEC intrastate switched access rates. A regulatory solution is, therefore, necessary, to bring those rates to more reasonable levels. The best practical solution to the problem of unreasonably high CLEC intrastate switched access rates is to establish a rate benchmark. This would be a simple and effective means of quickly moving the most excessive switched access rates in Arizona to more efficient levels.

Under the current regime, CLECs are able to shift too much of their costs to switched access purchasers (and their retail customers), thereby placing a disproportionate burden on other carriers in the state – and ultimately, their customers – to subsidize a CLEC's services. A benchmark, in contrast, will promote equity and competitive parity and reduce market distortions by prompting carriers with the highest access rates to recover more of their network costs from their own customers, rather than from other carriers and their customers through access rates.⁶⁶

Verizon, Qwest, Commission Staff and ALECA recommend that the intrastate switched access rates of the largest ILEC in the state – in this case, Qwest – should serve

⁶⁵ Ex. S-1 (Shand Direct) at 9.

⁶⁶ Ex. VZ-4 (Price Direct) at 13-14; Tr. at 354.

as the benchmark.⁶⁷ Qwest's intrastate access rates in Arizona have been subject to the most regulatory scrutiny in recent years.⁶⁸ Because the Commission has not conducted a similar review of rates of other local exchange companies in Arizona, the Qwest rates are, for the time being, the most reliable standard that the Commission can use for this purpose.⁶⁹

Setting a benchmark for CLEC access rates is efficient and consistent with the approach taken by the FCC and numerous other state commissions. Establishing a uniform policy that applies to all carriers is far more administratively efficient than the Joint CLECs' suggestion that the Commission open separate dockets and evaluate each carrier's rates individually on a case-by-case basis.⁷⁰ That approach is a prescription for regulatory paralysis (which is, no doubt, what the Joint CLECs intend).

Under the benchmarking approach proposed by Verizon, no CLEC would be permitted to charge more than Qwest's rate for intrastate switched access service. Access rates set at or below the benchmark would be presumed to be just and reasonable. Once the Commission adopts this policy, it can require CLECs to file tariffs that comply with the new requirement without the need for further regulatory proceedings. Because CLECs already are entitled to certain pricing flexibility for their retail services, these carriers should be permitted, if they wish, to adjust their rates for retail services to recoup some or all of the revenues previously generated through access charges,⁷¹ again without

⁶⁷ Ex. VZ-4 (Price Direct) at 15; Ex. ALECA-1 (Meredith Direct) at 7; Tr. at 202; Ex. Q-1 (Eckert Direct) at 7-8; Ex. S-1 (Shand Direct) at 2, 11.

⁶⁸ Ex. VZ-4 (Price Direct) at 7, 15; Ex. VZ-2 (Price Reply) at 3; *see also* Ex. Q-1 (Eckert Direct) at 3; Tr. at 413.

⁶⁹ Ex. VZ-4 (Price Direct) at 7-8; Ex. Q-1 (Eckert Direct) at 3-4.

⁷⁰ Ex. JCLEC-1 (Denney Direct) at 53-54.

⁷¹ Tr. at 318-319.

the need for further regulatory proceedings.⁷²

According to Commission Staff, increases to local rates that are “overall revenue neutral” (such as those described in the previous paragraph) could be made “outside of a rate case” and “would be permissible under the *Scates* case.”⁷³ With regard to CLECs, issues relating to the need for a “rate case” are of little relevance.⁷⁴ The Commission’s current regulations for the pricing of CLEC services do not require any fair value information when a carrier changes existing rates. Rather, CLECs are free to make changes to existing rates as long as the new prices do not exceed the CLECs’ approved maximum rates.⁷⁵

Accordingly, when the Commission issues its order capping CLEC access rates and ruling that CLEC access rates set no higher than Qwest’s intrastate rates are deemed just and reasonable, the Commission can similarly decide that revenue-neutral adjustments to the carrier’s retail rates are also just and reasonable. CLECs can thereafter file tariffs to implement those policy decisions without the need to initiate any “rate case” or fair value determination. If a CLEC is not able to increase retail rates in a revenue neutral manner under its current maximum rates (or does not have maximum rates set), the Commission should allow the CLEC to apply for an increase in its current maximum rates and to provide the necessary information for Staff to approve such rates. Currently,

⁷² The CLECs acknowledge that it would not be appropriate or make public policy sense to set up an access recovery fund for CLECs, such as the one proposed by ALECA for ILECs. Tr. at 583, 630; Ex. Cox-1 (Garrett Direct) at 10.

⁷³ Ex. S-1 (Shand Direct) at Executive Summary, ¶ 7.

⁷⁴ The Arizona Supreme Court has ruled that, in a competitive climate, “there is no reason to rigidly link the fair value determination to the establishment of rates.” *US West Comm. v. The Arizona Corp. Comm.*, 201 Ariz. 242, 246, 34 P.3d 351, 355 (2001). Rather, “fair value, in conjunction with other information may be used” in determining whether a CLEC’s rates are just and reasonable, and the Commission “has broad discretion” to determine the weight to be given various factors when making that determination. *Id.*

⁷⁵ See AAC R14-2-1109.

for new entrants and revisions to maximum rates, the Commission requires some limited fair value information but does not accord the fair value information substantial weight in its analysis.⁷⁶ The same procedure could be used in this instance and new retail maximum rates could be approved “in an expeditious manner,” in accordance with AAC R14-2-1110, to offset any revenues lost from reductions to the CLEC’s switched access rates.

1. The FCC Has Already Capped CLECs’ Interstate Access Rates in Arizona by Rule

Regulators and policymakers routinely use benchmarking to establish just and reasonable rates. To address concerns with excessive CLEC access rates at the federal level, the FCC in 2001 established a benchmark policy whereby a CLEC’s per minute interstate switched access charges may not exceed the interstate switched access rates of the ILEC with which the CLEC competes.⁷⁷ CLEC access charges that do not exceed the benchmark are presumed to be just and reasonable.⁷⁸ The FCC explained its benchmark policy as follows:

[A] benchmark provides a bright line rule that permits a simple determination of whether a CLEC’s access rates are just and reasonable. Such a bright line approach is particularly desirable given the current legal and practical difficulties involved with comparing CLEC rates to any objective standard of ‘reasonableness.’ Historically, ILEC access charges have been the product of an extensive regulatory process by which an incumbent’s costs are subject to detailed accounting requirements, divided

⁷⁶ See, e.g., *Application of Paetec Communications, Inc. – Tariff Filing for Approval of a New Administrative Charge*, Decision No. 71706 (June 3, 2010) at 3 (“Because of the nature of the competitive market and other factors, a fair value analysis is not necessarily helpful in evaluating the Company’s proposed tariff change. Therefore, while Staff considered the fair value rate base information of PAETEC, it did not accord that information substantial weight in its analysis of this matter.”)

⁷⁷ *CLEC Rate Cap Order* at ¶ 45. See 47 C.F.R. § 61.26(b); Ex. VZ-4 (Price Direct) at 11-12.

⁷⁸ *CLEC Rate Cap Order* at ¶ 40. The FCC allows CLECs to charge rates higher than those of the ILEC only through negotiated arrangements. The FCC reasoned that if a CLEC provides a superior quality of access service, or if it has a particularly desirable subscriber base, an interexchange carrier may be willing to pay access rates above the benchmark. *Id.* at ¶ 43.

into regulated and non-regulated portions, and separated between the interstate and intrastate jurisdictions. Once the regulated, interstate portion of an ILEC's costs is identified, our access charge rules specify in detail the rate structure under which an incumbent may recover those costs. This process has yielded presumptively just and reasonable access rates for ILECs.⁷⁹

The FCC's rule was prompted by persistent concerns that CLEC access rates varied dramatically and were frequently well above the rates charged by ILECs operating in the same area.⁸⁰ The FCC's price cap was, therefore, intended to prevent CLECs from imposing excessive access charges on interexchange carriers and their customers.⁸¹

CLEC switched access rates for interstate calls that originate or terminate in Arizona must, by FCC rule, not exceed the interstate switched access rates of Qwest, or of another ILEC with which the CLEC competes. The proposals of Verizon, Qwest, ALECA and Commission Staff would extend a similar benchmarking approach to the access rates for interexchange calls that originate *and* terminate in Arizona. If all carriers move to a single, uniform rate, as Verizon recommends, the competing ILEC rate for all CLECs will be the Qwest rate. The rate cap mechanism proposed by Verizon (and other parties) for CLEC and ILEC rates in Arizona would be calculated in the same, familiar manner that CLECs currently use to determine their interstate access charges.⁸²

CLECs in Arizona have been complying with an ILEC interstate rate benchmark rule for nine years. Neither Cox nor the Joint CLECs produced any evidence to show that the interstate rate benchmark has adversely affected them, other CLECs or

⁷⁹ *Id.* at ¶ 41.

⁸⁰ *Id.* at ¶¶ 22, 25.

⁸¹ *Id.* at ¶¶ 32-34.

⁸² Ex. VZ-4 (Price Direct) at 12. If the Commission declines to move all ILECs to Qwest's intrastate rate, Verizon recommends that the Commission prohibit any CLEC from charging access rates higher than the rates of the ILEC against which the CLEC competes.

their customers in any way. In light of that, the Joint CLECs' suggestions that applying the same access rate benchmark to intrastate calls would be "possibly confiscatory" and "invariably curtail" the ability of CLECs to expand their networks are simply not credible.⁸³ The alleged harms are especially dubious because a benchmark set at Qwest's intrastate rate (which is, itself, at the high end of Regional Bell Operating Company rates around the country) would still allow CLECs to charge an intrastate access rate in Arizona more than twice the amount they currently charge for interstate access.⁸⁴

2. Many States Have Also Adopted a Benchmarking Approach to Regulate CLEC Intrastate Access Rates

Numerous states have laws or regulations that generally mirror the FCC's price cap approach for CLEC access rates.⁸⁵ In fact, every state commission that has formally considered restraining CLEC access rates has concluded that a benchmarking approach is good policy.⁸⁶ This is a growing trend, as a number of additional state commissions and legislatures have taken action to impose limits on CLEC access rates in just the last year.

⁸³ Ex. JCLEC-1 (Denney Direct) at 34-35.

⁸⁴ Qwest's interstate switched access rate, which is used to determine compliance with the FCC's price cap requirement for CLECs in Arizona, is less than half its intrastate rate. See Ex. AT&T-2 (Aron Direct) at 34, 36 HIGHLY CONFIDENTIAL Table 1.

⁸⁵ See Ex. VZ-4 (Price Direct) at 15-16; Ex. Q-1 (Eckert Direct) at 8-9; Ex. AT&T-1 (Aron Direct) at 52-53.

⁸⁶ Ex. VZ-2 (Price Reply) at 5.

Connecticut,⁸⁷ Delaware,⁸⁸ Louisiana,⁸⁹ Maryland,⁹⁰ Massachusetts,⁹¹ Missouri⁹² New Hampshire,⁹³ New Jersey,⁹⁴ New York,⁹⁵ Ohio,⁹⁶ Pennsylvania,⁹⁷ Texas,⁹⁸ Virginia,⁹⁹ and West Virginia¹⁰⁰ have all imposed requirements like Verizon proposes here that prohibit CLECs from setting switched access rates higher than the ILEC's intrastate rate. Nebraska has a similar requirement that, absent a demonstration of costs, a CLEC's access charges, in aggregate, must be reasonably comparable to the rates of the

⁸⁷ *Investigation of Intrastate Carrier Access Charges*, Decision, Connecticut D.P.U. Docket No. 02-05-17 (February 18, 2004), 2004 Conn. PUC Lexis 15, at *45.

⁸⁸ Delaware Code, Title 26, § 707(e).

⁸⁹ Louisiana PSC General Order No. U-17949-TT, Appendix B, Section 301(k)(4) (May 3, 1996).

⁹⁰ Code of Maryland Regulations, § 20.45.09.03(b).

⁹¹ *Petition of Verizon New England Inc. et al. for Investigation Under Chapter 159, Section 14, of the Intrastate Access Rates of Competitive Local Exchange Carriers*, Final Order, Massachusetts D.T.C. 07-9 (June 22, 2009) ("Massachusetts DTC Order"); reconsideration denied (Dec. 7, 2009).

⁹² *Access Rates to be Charged by Competitive Local Exchange Telecommunications Companies in the State of Missouri*, Report and Order, Missouri P.S.C. Case No. TO-99-596, at 22-24 (June 1, 2001), 2000 Mo. PSC Lexis 996, at *28-31, affirmed *Investigation of the Actual Costs Incurred in Providing Exchange Access Service and the Access Rates to be Charged by Competitive Local Exchange Telecommunications Companies in the State of Missouri*, Report and Order, Case No. TR-2001-65 (September 5, 2003).

⁹³ New Hampshire PUC § 431.07.

⁹⁴ *In the Matter of the Board's Investigation and Review of the Local Exchange Carrier Intrastate Exchange Access Rates*, Telecommunications Order, New Jersey B.P.U. Docket No. TX08090830 (February 21, 2010) at 29-30.

⁹⁵ See, e.g. New York P.U.C. Case 94-C-0095, Order (Sept. 27, 1995) at 16-17; N.Y. P.S.C. Opinion 98-10, 1998 N.Y. PUC Lexis 325 (June 2, 1998) at 26-27.

⁹⁶ *Establishment of Carrier-to-Carrier Rules*, Entry on Rehearing, Ohio P.U.C. Case No. 06-1344-TP-ORD (October 17, 2007) at 16-18.

⁹⁷ 66 Pennsylvania Consolidated Statutes § 3017(c).

⁹⁸ Texas P.U.C. Subst. Rule § 26.223.

⁹⁹ *Amendment of Rules Governing the Certification and Regulation of Competitive Local Exchange Carriers*, Final Order, Virginia State Corporation Commission Case No. PUC-2007-00033 (September 27, 2007); 20 VAC 5-417-50(E)(1).

¹⁰⁰ *Petition by Verizon West Virginia Inc. Requesting that Commission Initiate a General Investigation of the Intrastate Switched Access Charges of Competitive Local Exchange Carriers Operating in WV*, Order, West Virginia PSC Case No. 08-0656-T-PC (Nov. 23, 2009).

ILEC with which the CLEC competes.¹⁰¹ California caps CLEC rates at no higher than the rates of the two largest ILECs in the state (SBC or Verizon), plus 10%.¹⁰²

A few other states have taken different approaches to constraining CLEC access rates. For example, in Indiana, a local exchange carrier's switched access rates are considered just and reasonable if they mirror the carrier's interstate switched access rates.¹⁰³ Lawmakers in Michigan,¹⁰⁴ Georgia¹⁰⁵ and Illinois¹⁰⁶ recently enacted legislation that would also require CLECs' intrastate switched access to be no higher than their interstate rates following a transition period. Iowa prohibits CLECs from assessing a carrier common line charge if it would render the CLEC's switched access rate higher than the competing ILEC's rate.¹⁰⁷ In Washington, a LEC's terminating access rates may not exceed its local interconnection rate or, depending on the company's regulatory status, incremental cost.¹⁰⁸

As with the FCC rule, the CLECs here presented no evidence that benchmark rules in other states have forced CLECs to exit the market or hindered their ability to

¹⁰¹ *In the Matter of the Commission, on Its Own Motion, Seeking to Conduct an Investigation into Intrastate Access Charge Reform and Intrastate Universal Service Fund*, Nebraska Pub. Serv. Comm'n Application No. C-1628/NUSF, Progression Order #15 (Feb. 21, 2001) at ¶ 9.

¹⁰² *Order Instituting Rulemaking to Review Policies Concerning Intrastate Carrier Access Charges*, D. 07-12-020, Final Opinion Modifying Intrastate Access Charges, California P.U.C. Rulemaking 03-08-018 (Dec. 6, 2007).

¹⁰³ Indiana Code § 8-1-2.6-1.5.

¹⁰⁴ 2009 PA 182, enacting MCL 484.2310(2).

¹⁰⁵ GA Code 46-5-166(d) became effective on June 4, 2010, after governor signed GA House Bill 168 into law.

¹⁰⁶ 220 ILCS 5/13-900.2(b) became effective on June 15, 2010, after governor signed Senate Bill 107 into law.

¹⁰⁷ 199 Iowa Admin. Code 22.14(2)(d)(1)(2).

¹⁰⁸ Washington Admin. Code § 480-120-540.

compete in those states.

3. Verizon's Proposed Benchmark Rule for Arizona Is Similar to the FCC Model

Verizon proposes that the Commission adopt the following requirement to regulate intrastate CLEC switched access rates in Arizona:

No competitive local exchange carrier ("CLEC") shall charge a rate for intrastate switched access services that is higher than the intrastate switched access rate of the largest incumbent local exchange carrier ("ILEC") in the state. The rate for intrastate switched access service shall mean the composite, per-minute rate for the service, including all applicable rate elements for the functions actually performed by the CLEC in providing service. This obligation is immediate and continuing.

This proposed language parallels requirements that have been established at the federal level and in a number of other states. The language is also consistent with the recommendations of Qwest, ALECA and Commission Staff that CLEC access rates be set no higher than Qwest's intrastate rates.¹⁰⁹ Because those parties along with Verizon also propose that ILEC access rates be capped at the level of Qwest's intrastate rate, the proposed language reflects the concept that all local exchange carriers in Arizona should be charging the same rate.

To comply with the benchmark rule, CLECs would follow the same methodology they use today to comply with the FCC rule. The cap would be set by using the composite of Qwest's intrastate switched access rate elements for the functions that the CLEC actually performs in providing switched access service. For example, if a CLEC does not use tandem switching in providing switched access service to another carrier, its cap cannot include Qwest's tandem switching rate. The benchmark cap initially would

¹⁰⁹ Ex. Q-1 (Eckert Direct) at 7-8; Ex. ALECA-1 (Meredith Direct) at 7; Ex. S-1 (Shand Direct) at 2, 11.

be \$0.022 per minute,¹¹⁰ assuming that the CLEC is providing functions equivalent to Qwest's intrastate Local End Office Switching, End Office Shared Port, and Tandem Switched Transport (based on an additional assumption of one mile of transport).¹¹¹ If Qwest's intrastate access rates in Arizona are reduced in the future, CLECs would be required to make corresponding adjustments to their own rates to be in compliance with the then-effective rate cap.

4. Relying on Qwest's Intrastate Rates as a Benchmark Is Not "Arbitrary," as the CLECs Claim

As demonstrated above, using Qwest's intrastate access rates as a benchmark for CLEC access rates in Arizona is supported by federal and state precedent. The standard is also reasonable because Qwest's rates have been subject to substantial regulatory scrutiny by the Commission in recent years. Dr. Aron explained further that in a competitive market, CLECs would not be permitted to charge a rate higher than that of the incumbent with which they compete. For regulation to mimic (to the extent possible) the outcome of a competitive market, the regulator would therefore cap the CLECs' intrastate rates at the competing ILEC's level. For these reasons, she concluded that, from an economic standpoint, any benchmark other than the rate charged by the competing ILEC would be arbitrary.¹¹²

The Joint CLECs nevertheless argue that reliance on Qwest's intrastate rate for this purpose is "arbitrary."¹¹³ However, the "facts" they cite in support of this contention

¹¹⁰ Ex. ALECA-1 (Meredith Direct) at 7; Ex. ALECA-2 (Meredith Reply) at 4; Ex. S-1 (Shand Direct) at 19.

¹¹¹ The cap for an individual CLEC could be higher or lower depending on whether calls are routed through an ILEC tandem and depending on the number of transport miles.

¹¹² Ex. AT&T-4 (Aron Rejoinder) at 23.

¹¹³ Ex. JCLEC-1 (Denney Direct) at 7-8; Tr. at 580.

are incomplete and incorrect.

The Joint CLECs' witness Mr. Denney asserted that

Qwest *intrastate rates* as they exist today are a result of a revenue neutral settlement that Qwest entered into *which CLECs were not a party to*. And that settlement took place over a six-year period and four different reductions that took place to get there. They weren't immediate, and Qwest had the opportunity, had the opportunity, they had the ability to flow through those reductions.¹¹⁴

This testimony mischaracterizes the regulatory proceedings that resulted in multiple reductions in Qwest's intrastate access rates in Arizona. In particular, Mr. Denney's reference to a single "settlement" overlooks the activity in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672 that culminated in a \$12 million reduction in access rates that the Commission approved in Decision No. 68604.¹¹⁵ Contrary to Mr. Denney's claim that "CLECs were not a party" to the process in which Qwest implemented significant switched access reductions, several CLECs were granted intervention and actively participated in that proceeding.¹¹⁶ Cox and Time Warner filed direct testimony,¹¹⁷ and three CLECs – Cox, Time Warner and XO – entered into a settlement agreement with Qwest and other parties, filed testimony in support of the settlement, and submitted closing briefs.¹¹⁸ In approving the settlement agreement, the Commission observed that the settlement negotiation process had been open to all active parties, the parties "represented a broad group of stakeholders," and all had participated

¹¹⁴ Tr. at 580 (emphasis added); *see also* Ex. JCLEC-1 (Denney Direct) at 8 (CLECs typically were not involved in the development of those rates).

¹¹⁵ *Qwest Corporation's Filing of Renewed Price Regulation Plan and Investigation of the Cost of Telecommunications Access*, Decision No. 68604, Opinion and Order (March 23, 2006).

¹¹⁶ Cox Arizona Telcom, Time Warner Telecom ("Time Warner"), XO Communications Services, Inc. ("XO"), Xspedious Management Co. Switched Services LLC, TCG Phoenix, and MCI were all granted intervention. *Id.* at 4 and 28 (Finding of Fact 9).

¹¹⁷ *Id.* at 4 and 28 (Finding of Fact 11).

¹¹⁸ *Id.* at 5, 21-23 and 29 (Findings of Fact 18, 20 and 24).

in the discussions.¹¹⁹

Given the diversity of the parties and their respective interests, the settlement agreement addressed a wide range of issues (not just switched access reductions and offsetting rate increases). Significantly, Time Warner (a CLEC) asserted that the entire agreement was “a reasonable compromise of the issues in the case” and urged the Commission to find the settlement to be in the public interest.¹²⁰ The fact that some changes in Qwest’s access rates were a product of negotiations among the parties to a proceeding on a price cap plan does not make the use of those rates as a benchmark “arbitrary,” as the Joint CLECs now argue – in fact, it is just the opposite, because a negotiated rate is the best way to approximate a market-based rate. In any event, the Commission subsequently reviewed the results of the settlement process and found that the rates it approved were fair and reasonable.¹²¹

To the extent CLECs in Arizona pay Qwest’s originating and terminating switched access rates on interexchange calls they terminate or originate, they benefited from the access charge reductions that were implemented as a result of these prior regulatory proceedings. It is fair to assume that the carriers were capable of effectively representing their interests in those cases when the rates for Qwest’s access services were

¹¹⁹ *Id.* at 25.

¹²⁰ *Id.* at 21-22.

¹²¹ *Id.* at 27. Contrary to Mr. Denney’s testimony, a number of CLECs also intervened in an earlier proceeding, Docket No. T-01051B-99-0105, that resulted in Qwest reducing its intrastate access charges in three steps. In that case, the Commission granted intervention to Cox Arizona Telecom, e-spire Communications, Excell, One Point Communications, ACI Corp. dba Excellerated Connections, Inc., Rhythm Links Communications, Cable Plus Co., Teligent Inc. and Arizona Dialtone, Inc. *See Application of US West Communications, Inc., a Colorado Corporation, for a Hearing to Determine the Earnings of the Company, The Fair Value of the Company for Ratemaking Purposes, to Fix a Just and Reasonable Rate of Return Thereon and to Approve Rate Schedules Designed to Develop Such Return*, Decision No. 63487, Opinion and Order (March 30, 2001) at 23 (Finding of Fact 8). Cox filed testimony and a brief in that case and addressed various aspects of the proposed settlement agreement. *See id.* at 3-4, 13-14, 16, 18, 20 and 23-24 (Findings of Fact 10, 12, 18 and 22).

at issue.¹²²

The Joint CLECs tried to glean significance in the fact that while certain “revenue neutral” changes were made when Qwest’s *interstate* access rates were revised by the FCC, the same changes were not made to Qwest’s retail rates when Qwest implemented a price cap plan for intrastate services in Arizona. Their witness stated that CLECs did not get the same “direct benefit when Qwest made the move to the intrastate rates. And that’s why we think it is improper to set the intrastate rates, Qwest intrastate rates as the benchmark.”¹²³ But the Joint CLECs’ discussion of Qwest’s *interstate* rates is irrelevant to the question of whether Qwest’s *intrastate* access rates are reasonable and appropriate for use as a benchmark for CLECs’ access rates at this time. Moreover, not only were Qwest’s intrastate rates subject to regulatory scrutiny, but the interstate rates of Qwest and other large exchange carriers were also established through a comprehensive and open process at the FCC that involved input from dozens of parties, including competitive carriers.¹²⁴

Accordingly, all of the arguments advanced by the Joint CLECs to show that the use of Qwest’s intrastate access rates as a benchmark for other carriers is arbitrary are without merit and should be disregarded.

5. Capping CLEC Access Rates Is Not Confiscatory

The Joint CLECs argue that a rate benchmark would be “deeply disruptive of the CLECs’ ability to compete,” cause “a significant portion of the CLECs’ costs to go

¹²² The record is clear that Time Warner and XO supported approval of the reduction in special access rates that was a component of the settlement agreement approved in Decision No. 68604. *See* Decision No. 68604 at 21-22.

¹²³ Tr. at 581-582.

¹²⁴ *See Access Charge Reform*, CC Docket No. 96-262, Sixth Report and Order, 15 FCC Rcd 12962 (2000) (“*CALLS*”) at fn. 1 and Appendix A.

unrecovered,” and possibly be confiscatory.¹²⁵ The Joint CLECs did not introduce any evidence to substantiate these allegations, and the Commission should ignore their hyperbolic rhetoric.

No party submitted evidence that CLECs are not recovering their costs under the FCC’s price cap regime for interstate access services. Cox admitted that it has not conducted any study of its interstate costs and rates.¹²⁶ It is therefore implausible that CLECs would not recover their costs if they set their intrastate access rates in accordance with the *higher* intrastate benchmark (Qwest’s intrastate rate) proposed by Verizon. Significantly, the Joint CLECs failed to present any information to substantiate their claim that a benchmarking policy “may” force CLECs to charge “below cost” access rates.¹²⁷ Nothing in Verizon’s benchmarking proposal would in any way limit the “cost” that any CLEC can recover from the services it provides or limit its ability to recover its costs from its end users. CLECs in Arizona currently have pricing flexibility for their retail services, and can look to their own end user customers for recovery of their costs. Thus, the question of whether a CLEC can recover its costs is not a genuine issue.

On the contrary, a primary objective of the benchmark approach is to prevent CLECs from imposing excessive costs on carriers that have no choice but to deliver traffic to and from the CLECs’ end users.¹²⁸ By recovering a disproportionate share of their costs from other carriers, rather than from their end users, CLECs have maintained inefficient and irrational price structures, which the FCC has said “lead to inefficient and

¹²⁵ Ex. JCLEC-1 (Denney Direct) at 34.

¹²⁶ Tr. at 229.

¹²⁷ Ex. JCLEC-1 (Denney Direct) at 34.

¹²⁸ Ex. VZ-2 (Price Reply) at 17.

undesirable economic behavior”¹²⁹ and, ultimately, to higher prices for consumers. Rather than disrupt a carrier’s ability to compete, as the Joint CLECs claim, the FCC concluded that requiring CLECs to recover more of their costs from their end users is economically efficient and promotes competition in both long distance and local service markets.¹³⁰ The FCC reasoned that if a CLEC incurs greater costs in providing access services and seeks to recover those costs from its retail customers, the end users receive correct price signals and can decide whether to seek out an alternative provider.¹³¹ The FCC has also concluded that moving to an economically rational pricing structure will benefit consumers, promote competition and efficiency, and provide economically correct entry incentives.¹³²

Under Verizon’s benchmark proposal, CLECs would be required to reduce their intrastate switched access rates to be no higher than Qwest’s, and they would have the ability to adjust their retail rates to offset any reduced revenues from their switched access services. Verizon agrees with Cox that CLECs should have “mechanisms and procedures [available] to facilitate recovery of lost access revenues,” including the ability to timely increase the maximum rates in approved tariffs.¹³³ The procedures Verizon recommends below fully address this need. For all these reasons, the Joint CLECs’ allegation that applying a benchmark to CLEC access rates will be confiscatory is false.

¹²⁹ *CALLS* at ¶ 129.

¹³⁰ *CLEC Rate Cap Order* at ¶¶ 33, 39, 43.

¹³¹ *Id.* at ¶¶ 39, 43.

¹³² *CALLS* at ¶¶ 77-78 and 114.

¹³³ Ex. Cox-2 (Garrett Reply) at 5-6.

G. The Alternative “Solutions” Proposed by CLECs Are Not Reasonable and Would Not Solve the Problem of Excessive Access Rates

In an attempt to maintain their ability to charge excessive access rates, the CLECs propose several alternatives to the benchmark approach advocated by Verizon and others. None of their proposals is reasonable and none would solve the problems caused by excessive CLEC access rates.

1. Reducing Terminating Access Rates Only Would Not Solve the Problem

The Joint CLECs argue that the Commission should limit any price reductions to terminating access rates only.¹³⁴ This proposal is based on the Joint CLECs’ claim that other parties only addressed “the CLECs’ asserted monopoly with regard to terminating access” and did not allege that CLECs have market power with respect to originating access.¹³⁵ As shown above, this is incorrect. The record demonstrates that CLECs possess market power over both originating and terminating access service.¹³⁶ Based on that fact, the FCC and those state regulators that have capped CLEC access rates have, with only one exception,¹³⁷ imposed limits on both originating and terminating access services. The Joint CLECs have not provided sufficient facts to warrant a different result here, nor have they justified leaving unchecked the excessive originating access rates charged by many CLECs in Arizona.¹³⁸ Accordingly, the Commission should reject this proposal and instead establish a ceiling on both originating and terminating switched

¹³⁴ Ex. JCLEC-2 (Denney Reply) at 5, 7-8.

¹³⁵ *Id.* at 5, 11.

¹³⁶ *See supra* at 7-10.

¹³⁷ Washington Admin. Code § 480-120-540 (pricing standards for LECs’ terminating access rates).

¹³⁸ *See, e.g.*, Ex. AT&T-4 (Aron Rejoinder) at 24-25, Figure 1; Ex. JCLEC-1 (Denney Direct) at 19 (showing that the “average” originating rate of the Joint CLECs is 62 percent higher than Qwest’s current originating switched access rate, and that one CLEC charges two and one-half times the Qwest rate).

access rates.

2. Using Qwest's Rates in Effect in 1999 Would Not Solve the Problem

The Joint CLECs recommend that if the Commission establishes a benchmark for CLEC access rates, the appropriate standard should be Qwest's intrastate access rates that were in effect in 1999, *more than a decade ago*.¹³⁹ The theory underlying this proposal is that many CLECs were entering the market during that time period and would have considered Qwest's then-current rates when they "made the determination on whether they could enter and compete in local markets."¹⁴⁰ Mr. Denney treats the subsequent, sizeable rate decreases implemented by Qwest as irrelevant, on the grounds they were the product of revenue neutral settlement agreements entered into "for Qwest's benefit."¹⁴¹

The Commission should reject this proposal. Qwest's current access rates are the result of extensive review by the Commission and, as discussed above, are a reasonable proxy or benchmark for CLECs. The rates in effect eleven years ago have long since been superseded and provide no rational basis for a determination of what rates are just and reasonable today.¹⁴² The Massachusetts DTC rejected a similar argument that a benchmark for CLEC access rates should be based on the ILEC's rates that were in effect before they were reduced to current levels.¹⁴³

The Joint CLECs' argument fails for other reasons, as well. In the face of

¹³⁹ *Id.* at 8, 49.

¹⁴⁰ *Id.* at 49; Ex. JCLEC-2 (Denney Reply) at 29-30.

¹⁴¹ Ex. JCLEC-2 (Denney Reply) at 30.

¹⁴² A comparison of historical rate information contained in Mr. Denney's reply testimony (*id.* at 2) with Qwest's current access rates indicates that Qwest's terminating switched access rate today is 54% less than it was in 1999, and its current originating rate is 35% lower.

¹⁴³ *Massachusetts DTC Order, supra*, at 28.

numerous rate reductions made by Qwest in the past decade, the fact that CLECs failed to lower their switched access rates in response simply confirms that no competitive market pressures operate to discipline their rates.¹⁴⁴ Predicating access charge policy today on speculation about what some carriers' expectations might have been eleven years ago¹⁴⁵ would also be irrational. Any prudent business plan at the time would have taken into account the likelihood that new market entry, increased competition, improved technology and innovation would lead to lower prices over time.¹⁴⁶ Policy changes that led to the emergence of competition in local exchange markets actually presumed that lower prices would be one of the beneficial outcomes of increased competition. It would therefore have been naïve to predicate an initial business plan on the assumption that other firms would not respond to new market entry and that prices would remain static in the future. In fact, CLECs were well aware of the potential for access rate reductions, and repeatedly included warnings about the risk of access charge reductions in their statements to shareholders during that period.¹⁴⁷ Interstate access charges already were undergoing change at the time,¹⁴⁸ and CLECs have been on notice since 2001 that their intrastate access charges in Arizona could be changed in this proceeding.¹⁴⁹ Thus, any suggestion that CLECs reasonably expected access rates to remain constant in future years is unsubstantiated and belied by their own actions.

Whatever assumptions some CLECs may have made upon entering the market are

¹⁴⁴ See *supra* at 6-7.

¹⁴⁵ The Jt. CLECs' witness admitted that he had no actual knowledge of any of the CLECs' specific business plans. Tr. at 594-595.

¹⁴⁶ Ex. VZ-3 (Price Rejoinder) at 8-9; Ex. AT&T-3 (Aron Reply) at 31-33.

¹⁴⁷ Ex. AT&T-3 (Aron Reply) at 33-34 and Exhibit DJA-R2.

¹⁴⁸ See *CLEC Rate Cap Order* at ¶¶ 1, 7-10 and 19 and proceedings cited therein.

¹⁴⁹ See Procedural Order, Docket No. T-00000D-00-0672 (Dec. 3, 2001).

irrelevant to the Commission's determination of what constitutes reasonable access rates today. Relying on eleven year-old rates as a contemporary price benchmark would be arbitrary and unreasonable. Accordingly, the Commission should reject this proposal.

3. Allowing CLECs to Charge More Than the ILEC Would Not Solve the Problem

Cox requests that CLECs be permitted to establish rates "modestly above" the ILEC's rate, ostensibly to "recognize the differences in CLEC networks and costs."¹⁵⁰ However, Cox did not present any evidence demonstrating that any such "differences" exist, let alone that they are material. Moreover, Cox suggested that no examination of individual CLEC costs would likely be forthcoming.¹⁵¹ Accordingly, there is no evidentiary basis on which the Commission could conclude that CLECs should be treated differently than Qwest or other ILECs. Cox also failed to articulate any policy basis for allowing CLECs to charge rates higher than Qwest, their largest competitor. Indeed, if the Commission were to permit such a "cushion," the effect would be to penalize other carriers with more reasonable rates by allowing some CLECs to continue to distort the market.

Cox acknowledges that it relies on access revenues to support its competitive operations, and is obviously motivated by a desire to protect that source of funding. However, there is no principled basis for allowing a CLEC to charge other carriers excessive access rates to support its competitive retail services. Accordingly, there is no evidentiary or policy basis for accepting Cox's suggestion that CLECs should be permitted to continue charging access rates higher than Qwest.

¹⁵⁰ Ex. Cox-2 (Garrett Reply) at 6.

¹⁵¹ *Id.* (stating that an examination of individual CLEC costs would be costly, resource intensive, lengthy, and contentious, and thus not practical for many CLECs.)

4. Setting CLEC Access Rates Based on Each CLEC's Cost Would Not Solve the Problem

The Joint CLECs claim that if CLEC access rates are to be reviewed, the “most proper basis for review is each CLEC’s cost.”¹⁵² This argument is flawed for many reasons. The Joint CLECs’ proposal ignores the fact that CLECs historically have not been subject to cost-of-service regulation and that the Commission has not previously examined the costs CLECs incur to provide switched access.¹⁵³ The Joint CLECs do not point to any instance in which any CLEC has developed an intrastate switched access cost study in Arizona and, in fact, acknowledge that such cost studies do not exist and would have to be developed “at a later date.”¹⁵⁴ Most important, they offer no explanation or policy rationale for why the Commission and individual carriers should embark on such a complex undertaking at this stage of the industry’s development.

The CLECs’ advocacy is internally inconsistent on this point, which further undermines the credibility of their position. While extolling the need for a cost review, the parties emphasize that they do not welcome such proceedings. Cox cites the benefits of “*avoiding* the costly and likely contentious examination of individual costs,” pointing out that the preparation of cost studies “would be a resource intensive and lengthy option that *is not practical* for many CLECs.”¹⁵⁵ Likewise, the Joint CLECs warned that “[t]he cost of a proceeding to review access charges and implement possible changes would likely far exceed the benefit of doing so. In fact, CLECs will bear costs grossly

¹⁵² Ex. JCLEC-1 (Denney Direct) at 24, 8.

¹⁵³ See Tr. at 81 (RUCO) (explaining that CLECs typically do not follow the Uniform System of Accounts relied upon by regulators).

¹⁵⁴ Ex. JCLEC-1 (Denney Direct) at 25; Tr. at 607, 635.

¹⁵⁵ Ex. Cox-2 (Garrett Reply) at 6 (emphasis added); see also Tr. at 81 (RUCO witness Dr. Johnson stating that it would not be appropriate to demand company-specific cost studies from CLECs, and that doing so would not accomplish very much other than to impose a burden on CLECs).

disproportionate to their revenues ... without any prospect of a benefit.”¹⁵⁶ Accordingly, the Joint CLECs’ suggestion that access charge reform must be contingent on an examination of each CLEC’s costs is inconsistent with industry practice, is not realistic, and should not be taken seriously.

One of the chief benefits of a benchmarking approach, such as the one proposed by Verizon, is that it avoids the need to engage in a detailed examination of the costs of individual CLECs. The FCC did not evaluate CLEC costs when it adopted a benchmarking approach for interstate access services nine years ago, finding instead that the ILEC’s charge represented a fair market rate for interstate access services.¹⁵⁷ Earlier this year, the FCC emphatically rejected a CLEC’s request to set access rates above the established benchmark based on the CLEC’s costs. In doing so, the FCC reiterated that it had “specifically disclaimed reliance on cost to set competitive LEC access rates and instead applied a market-based approach” when it adopted the rule capping CLEC access rates.¹⁵⁸ The states that have established access rate benchmarks likewise have not examined CLEC costs before doing so.

The Commission should also decline the Joint CLECs’ invitation to examine their access costs, because such a review would likely produce little of any value. All CLECs in Arizona must currently comply with the FCC’s cap on their interstate access rates. Notably, the Joint CLECs did not contend that the FCC’s price cap rule precludes any CLEC from recovering its costs of providing switched access. Accordingly, it is difficult

¹⁵⁶ Ex. JCLEC-1 (Denney Direct) at 7; Tr. at 635 (preparing cost studies would be burdensome, a lot of work and expensive).

¹⁵⁷ *CLEC Rate Cap Order* at ¶ 41.

¹⁵⁸ *Petition of Northern Telephone & Data Corp. for Waiver of Section 61.26(b)(1) of the Commission’s Rules*, DA 10-72, WC Docket No. 09-216 (Jan. 13, 2010) at ¶ 7.

to imagine that the higher intrastate rate cap proposed by Verizon here (Qwest's intrastate rate) would not be sufficient to enable a CLEC to fairly recover its costs.

While the Joint CLECs claim that cost must play an important role in the Commission's determination of the reasonableness of CLEC access rates, they admittedly did not provide any evidence about any carrier's actual costs.¹⁵⁹ Thus, even if their contention that CLEC costs must be taken into account were correct (which it is not), the Joint CLECs failed to present any cost information that would justify the current (excessive) level of their intrastate switched access rates.

At most, the Joint CLECs presented theoretical arguments that differences in CLEC and ILEC networks could result in CLECs facing higher costs than ILECs.¹⁶⁰ However, they failed to quantify any of these claims, let alone prove that they should be entitled to charge more than Qwest for switched access service.¹⁶¹ Moreover, the notion that CLECs have higher cost structures than ILECs with legacy network architectures and customer bases is implausible. Because many CLECs did not enter the market until the late 1990's, they were able to design optimally efficient and cost-effective networks using the most up-to-date technology available (*e.g.*, digital switches and fiber optic transmission facilities).¹⁶² In addition, unlike incumbents, the newer market entrants have no obligation to serve residential customers in rural or other high-cost areas, but are free to serve (or not serve) whatever geographic areas and customer groups they want. CLECs therefore should be able to operate at least as efficiently as the incumbent carriers

¹⁵⁹ Ex. JCLEC-3 (Denney Rejoinder) at 17 ("Cost models of Arizona CLECs have not been filed ... in this case.")

¹⁶⁰ See Ex. JCLEC-1 (Denney Direct) at 26-30.

¹⁶¹ Ex. AT&T-3 (Aron Reply) at 26-28.

¹⁶² Ex. VZ-4 (Price Direct) at 10; Ex. AT&T-3 (Aron Reply) at 27; Ex. AT&T-9 (Oyefusi Reply) at 5; Ex. R-1 (Johnson Direct) at 21.

with their legacy networks and regulatory obligations. Moreover, as Dr. Aron explained, even if CLECs' costs were higher than those of the ILEC, "as a purely economic matter,... a competitive market would not permit CLECs to charge a higher price than that of the ILEC."¹⁶³

CLECs presented similar arguments to the FCC, claiming that their high interstate switched access rates "are justified by their substantial network development costs and their significantly higher per-unit cost of providing service that arises from the smaller customer base over which they may spread their operational costs." The FCC was not persuaded, but found instead that high access charges "may allow some CLECs inappropriately to shift onto the long distance market in general a substantial portion of the CLECs' start-up and network build-out costs." The FCC concluded that such cost shifting "is inconsistent with the competitive market."¹⁶⁴

Even if the CLECs' dubious claim that some of them have higher costs were credible, it is beside the point. From an economic efficiency perspective, costs generally should be recovered from the cost causers – that is, a carrier's own end users – and not from other carriers and their end users. Here, the Joint CLECs admit that they have designed and constructed their networks in order to better serve *their end user customers*.¹⁶⁵ Accordingly, these carriers should recover the costs incurred in deploying those networks from their own retail customers. If, as alleged, a CLEC incurs higher costs to provide better service to its retail customers, it is not fair to impose a disproportionately greater share of those costs on interconnecting – and often competing

¹⁶³ Ex. AT&T-3 (Aron Reply) at 26 fn. 31, and 36.

¹⁶⁴ CLEC Rate Cap Order at ¶¶ 27, 33.

¹⁶⁵ Ex. JCLEC-1 (Denney Direct) at 28.

– carriers through the payment of inflated access charges. Thus, even if CLEC costs were higher, the economically efficient and pro-competitive approach is to require those carriers to recover a greater portion of those costs from their own customers.

H. The Commission Should Implement Needed Access Charge Reform in Arizona Now Without Waiting for Further Action by the FCC

Cox professes to support reducing all intercarrier compensation rates “to zero or ‘bill and keep,’” albeit “over a relatively long period,” but urges the Commission not to do anything to reduce intrastate access charges until the FCC completes a recently-announced review and reform of access charges on a national scale.¹⁶⁶ The Commission should reject pleas that it refrain from taking swift action and enacting reforms in Arizona that are fully justified by the record.

The suggestion that guidance from the federal government is needed before this Commission can move ahead is a red herring. The FCC already has spoken on the issue of CLEC access rates: it issued rules nine years ago limiting CLECs to charging no more than the competing ILEC for interstate switched access service. The FCC determined that the market does not constrain CLECs’ switched access rates, and that direct regulatory intervention in the form of a price cap is therefore necessary to insure that those rates are reasonable. The interstate and intrastate access markets are no different in this regard.

More recently, the FCC’s National Broadband Plan identified reform of the intercarrier compensation system – including reducing carriers’ intrastate switched access rates – as a critical, but as-yet unmet, goal.¹⁶⁷ The *NBP* recommends adoption of a

¹⁶⁶ Ex. Cox-1 (Garrett Direct) at 5-8; *see* Tr. at 222-223.

¹⁶⁷ *See* Federal Communications Commission, “Connecting America: The National Broadband Plan” (“*NBP*”) (March 16, 2010) at 148 (copy available on-line at <http://www.broadband.gov/download-plan/>).

framework for long-term intercarrier compensation reform that will *eliminate* per-minute access charges in ten years.¹⁶⁸ The first phase of this process, to be accomplished in two to four years, is to “move carriers’ intrastate terminating switched access rates to interstate terminating switched access rate levels in equal increments.”¹⁶⁹ The *NBP* also “encourag[es] states to complete rebalancing of local rates to offset the impact of lost access revenues.”¹⁷⁰ Verizon’s recommendations here are consistent with the FCC’s most recent pronouncements on the necessity of access reform.

Verizon and other parties have simply proposed that the Commission take action in Arizona that conforms to the FCC’s longstanding national policy with respect to CLEC access charges. CLECs have been operating under the FCC’s price cap rules and those of many other states for several years, so compliance with a similar requirement in Arizona should be straightforward.

Cox’s contention that a national solution is the “only viable way” to reform intrastate CLEC access charges¹⁷¹ is similarly misplaced. While comprehensive reform efforts at the federal level would certainly be beneficial for the industry as a whole, this Commission has the jurisdiction and responsibility to ensure that intrastate rates in Arizona are just and reasonable. The Commission can proceed with necessary corrective action now, and address at a later date any issues that might arise as a result of *further* FCC action, sometime in the future. As indicated above, regulators and legislators in many other states are moving ahead with access reform efforts within their own states,

¹⁶⁸ See *NBP* at 148 (Recommendation 8.7).

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ Ex. Cox-1 (Garrett Direct) at 6.

and – consistent with prior FCC decisions – are imposing caps on CLEC access rates similar to those that parties are advocating here. Delaying needed reform efforts in Arizona, as Cox is hoping for, would only perpetuate excessive access charges that are harmful to both consumers and competition.

I. No Transition Period Is Needed for CLECs to Reduce Their Access Charges

In an attempt to preserve their ability to charge unreasonably high access rates as long as possible, the Joint CLECs ask that any required reductions be phased in over a transition period lasting “at least 8 to 10 years.”¹⁷² Cox suggests that a transition period of two to three years would be “appropriate.”¹⁷³ However, neither party demonstrated that such a prolonged transition is warranted. Accordingly, the Commission should reject the notion that any transition period is needed.

If the Commission finds that CLEC access rates are unreasonable, it should immediately require carriers to reduce their rates to a reasonable, lawful level. The fact that CLECs have enjoyed excessive rates for so long does not entitle them to keep imposing unreasonably high charges on other carriers for any greater amount of time.¹⁷⁴

CLECs have substantial flexibility under the Commission’s rules to immediately modify their retail rates to offset any foregone access revenues. Thus, the suggestion that CLECs require years to put new business plans in place and make adjustments to their retail rates is not credible.¹⁷⁵ The CLECs’ advocacy may, in fact, reflect more about the

¹⁷² Ex. JCLEC-2 (Denney Reply) at 30; Ex. JCLEC-1 (Denney Direct) at 13, 52.

¹⁷³ Ex. Cox-2 (Garrett Reply) at 4.

¹⁷⁴ Ex. AT&T-3 (Aron Reply) at 46, 48-49.

¹⁷⁵ See Ex. Cox-2 (Garrett Reply) at 4; Ex. JCLEC-1 (Denney Direct) at 9. Dr. Aron explained that CLECs failed to substantiate their claims that a CLEC’s contracts with retail customers might inhibit the carrier’s

confidence some carriers have in their ability to compete fairly and effectively in the competitive retail market. As Dr. Aron testified,

the proposed access reform amounts to replacing a monopoly revenue stream from IXC's with the opportunity to earn revenue in the competitive market. ... [T]here is no necessary 'financial loss' associated with the proposed access reform unless the CLECs are not able to compete effectively in the retail market. The necessity of all LECs to compete effectively in the retail market is a social benefit of access reform, not a defect.¹⁷⁶

Suggestions by CLECs of impending business harm resulting from adoption of Verizon's benchmarking proposal are completely unsubstantiated and implausible in light of the fact that CLECs have been able to compete in other states where their rates are capped, and that in Arizona they have complied with a cap set at even a lower level (Qwest's interstate rate) for years in the interstate jurisdiction.

CLECs have been aware for many years — at least since 2001 when the FCC adopted its rule — that unreasonably high CLEC switched access rates is a national regulatory issue and that states may choose, as many have, to follow the FCC's model and cap CLEC intrastate switched access rates. In Arizona, CLECs have long been on notice that a reduction in their intrastate access rates was possible. In fact, as early as December 2001, at the outset of this docket, the Commission expressly advised the industry that it might begin addressing the switched access charges assessed by CLECs.¹⁷⁷ The recent hearing was also preceded by two years of workshops and industry discussions about the prospects for and specifics of access charge reform. Thus, Arizona CLECs already have had plenty of time and notice to incorporate the potential for policy

ability to reduce its access rates quickly, and that, in any event, the existence of any such contracts is not a sufficient basis for delaying needed access reform. Ex. AT&T-3 (Aron Reply) at 50-53.

¹⁷⁶ Ex. AT&T-3 (Aron Reply) at 47.

¹⁷⁷ Procedural Order, Docket No. T-00000D-00-0672 (Dec. 3, 2001).

changes arising out of this proceeding into their business planning. Accordingly, no additional phase-in or transition period is necessary.

IV. THE SWITCHED ACCESS RATES OF RURAL INCUMBENT LECS ARE EXCESSIVE AND SHOULD ALSO BE REDUCED

The reasons for reducing CLEC access rates, discussed above, apply with equal force to the intrastate access rates of rural LECs. While the Commission has disciplined Qwest's access rates by approving several price reductions in recent years, all other ILECs in Arizona charge intrastate access rates that are many multiples higher than Qwest's. As with excessive CLEC access rates, the ILECs' inefficient and irrational rate structures distort the communications market, impair competition and harm consumers.¹⁷⁸

Through their industry association, ALECA, the ILECs confirmed that all of the essential predicates for access reform are present. ALECA agreed that ILECs' current access rates contain undue "implicit supports" and are "so high" as a result.¹⁷⁹ It acknowledged that excessive access rates have harmful consequences, including incentives for price arbitrage.¹⁸⁰ And the ILECs agreed that "intrastate access reform is in the public interest."¹⁸¹ In particular, ALECA supported proposals to cap all rural LECs' access rates at the level of Qwest's intrastate rate.¹⁸² Significantly, no party disputed the notion that the ILECs' intrastate access rates should be reduced.¹⁸³ Any disagreements among the parties relate instead to the manner in which ILECs might be

¹⁷⁸ Ex. VZ-4 (Price Direct) at 12-13; Ex. AT&T-1 (Aron Direct) at 26.

¹⁷⁹ Tr. at 207.

¹⁸⁰ Ex. ALECA-1 (Meredith Direct) at 6.

¹⁸¹ *Id.*; Tr. at 131.

¹⁸² Ex. ALECA-1 (Meredith Direct) at 7.

¹⁸³ RUCO's witness testified that "some access reductions may be appropriate." Ex. R-1 (Johnson Direct) at 18.

able to recover the reduced revenues they experience when they lower their access rates.

A. The Switched Access Rates of ILECs Greatly Exceed the Rates of Qwest

The evidence undeniably demonstrates that the intrastate switched access rates of rural LECs in Arizona significantly exceed those of Qwest. In fact, the disparity between the ILECs' current rates and Qwest's rate is much greater than the difference between Qwest's rate and the rates charged by CLECs, discussed above. Thus, there is an even more compelling need to lower the ILECs' intrastate access rates.

Commission Staff provided a detailed comparison of the intrastate switched access rates of ALECA members and Qwest, which documents the substantial differences in the carriers' respective charges by rate element.¹⁸⁴ Dr. Aron's independent evaluation of price information provided by LECs in discovery showed that the average ALECA carrier charges more than four times as much as Qwest to originate or terminate an interexchange call in Arizona.¹⁸⁵ Verizon's analysis reached similar conclusions. Using actual LEC access bills sent to Verizon, Verizon calculated the carriers' average access revenues per minute ("ARPM").¹⁸⁶ Verizon found that many LECs' intrastate access rates in Arizona are 400% to 1000% higher than Qwest's.¹⁸⁷

The independent LECs do not dispute this evidence; on the contrary, they admit

¹⁸⁴ Ex. S-1 (Shand Direct) at 2 and Exhibit WMS-1.

¹⁸⁵ Ex. AT&T-2 (Aron Direct) at 35-36, HIGHLY CONFIDENTIAL Table 1.

¹⁸⁶ Because different carriers often employ different access rate structures, it is useful to compare carriers' average access revenues per minute ("ARPM"). The ARPM takes into account all of the usage-based elements that the carrier charges its access customers, and generally provides a more "apples-to-apples" comparison of the aggregate, per-minute rate than a review that compares only particular rate elements. Ex. VZ-4 (Price Direct) at 14.

¹⁸⁷ *Id.* at 15.

that their rates are “high” because they are built on “implicit supports.”¹⁸⁸ ALECA also pointed out that its members’ intrastate composite switched access rates in Arizona are on average about nine cents per minute higher than the carriers’ respective interstate access rates.¹⁸⁹ ALECA acknowledges that this situation creates opportunities for price arbitrage, and therefore agrees that access charge reform “is in the public interest.”¹⁹⁰

B. ILEC Switched Access Charges Should Be Capped at the Level of Qwest’s Intrastate Rate

As explained above, unreasonably high switched access rates are harmful to consumers and competition in the markets for local and interexchange services. Particularly in the case of Arizona ILECs, whose unreasonably high access charges historically have provided a mechanism for subsidizing local exchange services to a disproportionate degree, this distortion artificially slows the emergence of local exchange competition.¹⁹¹ Conversely, access charge reform here will produce significant public benefits. The benefits of access reform, described in Sections III C-E above, apply equally to switched access services provided by ILECs, so that discussion need not be repeated here.¹⁹²

ALECA conceded that the intrastate switched access rates of rural LECs are excessive and should be reduced. It agreed with Verizon, Qwest and Commission

¹⁸⁸ Tr. at 207.

¹⁸⁹ Ex. ALECA-1 (Meredith Direct) at 6; Tr. at 133, 146, 155-156.

¹⁹⁰ Ex. ALECA-1 (Meredith Direct) at 6.

¹⁹¹ See Tr. at 407-408, 427-428; Ex. Sprint-3 (Appleby Reply) at 4; Ex. Q-1 (Eckert Direct) at 4 (“With the advent of competition, allowing implicit subsidies becomes increasingly difficult”); Ex. AT&T-1 (Aron Direct) at 26 (“you can have efficient competition, or you can have implicit cross subsidies built into regulated prices, but you cannot have both”).

¹⁹² See also Tr. at 408.

Staff¹⁹³ that the most “appropriate” approach is to cap ILEC rates at the level of Qwest’s intrastate rate.¹⁹⁴ This is because Qwest’s rates have been subject to extensive regulatory scrutiny, whereas the access rates of other ILECs in Arizona have not been reviewed in many years.¹⁹⁵ Mr. Meredith, the ALECA witness, acknowledged that Qwest’s current rates were “fully vetted” in Qwest’s last rate case and, for that reason, agreed that they provide a reasonable benchmark for other ILECs to follow.¹⁹⁶

ALECA testified that the information in the record is sufficient to enable the Commission to establish Qwest’s rates as a benchmark for other ILECs in this docket, without any need for further proceedings.¹⁹⁷ ALECA did not see any benefit to having the Commission examine any carrier’s costs before setting a rate cap at the level of Qwest’s rates.¹⁹⁸ It considered any such cost review to be time consuming, expensive and unnecessary.¹⁹⁹

Verizon’s proposal to establish a uniform benchmark rate (Qwest’s intrastate rate) is superior to AT&T’s recommendation that each carrier match its own interstate rates.

¹⁹³ Prior to the hearing, Staff modified its position somewhat. Staff’s revised recommendation is that ALECA members’ intrastate access rates should be reduced to the level of Qwest’s intrastate access rates or the carrier’s own interstate rates, whichever are higher. According to Staff, this modification would affect only two ILECs. Ex. S-5 (Shand Rejoinder) at 2-3; Tr at 650-651. While Verizon does not think this refinement is necessary, it does not oppose Staff’s modification.

¹⁹⁴ Ex. ALECA-1 (Meredith Direct) at 7 (noting that Qwest’s rate is publicly available and “provides a simple and straightforward target rate for switched access reform”); *see also* Ex. ALECA-3 (Meredith Rejoinder) at 2; and Ex. ALECA-2 (Meredith Reply) at Exhibit DDM-R1 (Response to Issue No. 2) (“eliminating the CCL rate element is also an important step in the right direction”).

¹⁹⁵ Staff testified that “Qwest is the only incumbent local exchange company to have its rates examined in almost ten years.” Ex. S-1 (Shand Direct) at 19 and S-2 (errata); *see also* Ex. S-1 (Shand Direct) at Exhibit WMS-1 (showing that, with one exception, all of the ALECA members’ current access rates were tariffed between 1990 and 1998. The most recent access tariff rate filing by any of these carriers was made in September 2000).

¹⁹⁶ Tr. at 202.

¹⁹⁷ Tr. at 195.

¹⁹⁸ Tr. at 195, 208.

¹⁹⁹ Tr. at 195-196, 207.

The evidence shows there are significant variations among the ILECs' interstate rates.²⁰⁰

Thus, the intrastate rates of some ILECs would remain comparatively high if the companies were required to simply match their high interstate rates. A single uniform rate, on the other hand, promotes equity and is more competitively neutral.

In sum, the record provides substantial support for the Commission to find in this proceeding that 1) current ILEC access rates are unreasonably high, 2) capping ILEC rates at the level of Qwest's intrastate rates is a reasonable policy and in the public interest, and 3) preventing ILECs from charging access rates higher than Qwest's will better ensure that the ILECs' rates are just and reasonable. Other states have imposed limits on ILEC access rates, so lowering ILEC rates to more reasonable levels in Arizona would also be consistent with that precedent.²⁰¹ Accordingly, the Commission should require all ILECs to comply with the same rate cap that Verizon has proposed for CLECs – Qwest's intrastate rate. Doing so will reduce market distortions by prompting carriers with the highest access rates to recover more of their network costs from their own customers, rather than from other carriers and their customers through excessive access rates. Establishing a uniform regulatory policy for all local exchange carriers is reasonable and will promote equity and competitively parity.²⁰²

²⁰⁰ See Ex. AT&T-10 (Oyefusi Reply) at CONFIDENTIAL Exhibit A (column labeled "Current Composite Interstate Access Rate") (showing that some ALECA members' interstate access rates are more than three times higher than the interstate rates charged by other ALECA members); Tr. at 172.

²⁰¹ For example, the rules and legislation in Connecticut, Delaware, Indiana, Maryland, New Jersey, Washington, Michigan, Georgia and Illinois cited on pages 25-26 above also address ILEC access charges. See also Ex. AT&T-1 (Aron Direct) at 48-51; Ex. Sprint-1 (Appleby Direct) at 9-10.

²⁰² Ex. VZ-4 (Price Direct) at 13-14. See Ex. ALECA-1 (Meredith Direct) at 7; Ex. Sprint-4 (Appleby Rejoinder) at 5.

C. It Is Not Necessary to Expand the AUSF to Implement Access Charge Reform. Instead, ILECs Should Be Afforded Sufficient Pricing Flexibility to Enable Them to Recover Reduced Access Revenues From Their End User Customers

All LECs should be granted sufficient retail pricing flexibility for their regulated services to afford the carriers a sufficient opportunity to recover their network costs.²⁰³ Carriers should recoup any foregone access revenues that they choose not to absorb through their rates for retail services, rather than by seeking to expand the AUSF and using it as a mechanism for replacing access charge revenues.²⁰⁴

AT&T's witness Dr. Aron testified that allowing the ILECs to recover foregone access revenue through increased retail rates "would be the most economically efficient means of recovering those revenues, and would best promote competition and efficient investment."²⁰⁵ She added that "[f]rom a purely economic perspective," adjusting retail rates to better recover their costs is a "generally superior" approach.²⁰⁶ Requiring carriers to recover their revenues through increases in the rates for their various local services will subject those rates to the forces of a competitive market. Because those revenues could be competed away, carriers will be likely to charge reasonable rates. Thus, moving ILEC local rates closer to cost will send appropriate pricing signals to the market and create incentives for ILECs to operate more efficiently.²⁰⁷

ILECs can implement the necessary access rate reductions and any offsetting

²⁰³ Ex. VZ-4 (Price Direct) at 3-4; Ex. Sprint-3 (Appleby Reply) at 3, 20; Tr. at 354.

²⁰⁴ Ex. VZ-4 (Price Direct) at 4; Ex. Sprint-1 (Appleby Direct) at 22-23; *see also* Ex. R-1 (Johnson Direct) at 18 ("some increase in local rates may be merited.")

²⁰⁵ Ex. AT&T-1 (Aron Direct) at 14.

²⁰⁶ *Id.* at 90-91; Ex. AT&T-3 (Aron Reply) at 60 (in contrast, recovering all foregone access revenues from the AUSF "would perpetuate a subsidy system by which retail prices are kept inefficiently low"); *see also* Tr. at 344.

²⁰⁷ Tr. at 408, 423-424.

increases to their retail rates fairly rapidly. Commission Staff testified that if the rate increases are “overall revenue neutral,” an ILEC could make those changes “outside of a rate case.”²⁰⁸ Staff also explained that such an approach “would be permissible under the *Scates* case.”²⁰⁹ Other parties agreed with Staff.²¹⁰ Such retail tariff filings need not prompt a “fair value” determination. This is because revenue neutral rate changes would not increase the carrier’s total revenues, nor would they affect the value of the carrier’s in-state property or investment. Rather, the revenue neutral change to rates would simply amount to a revision of the ILEC’s rate design to accomplish the approved revenue requirement.

Here, where the proposals are to permit revenue neutrality through the rebalancing of rates when access charges are reduced, confiscation is not an issue and, therefore, a rate case to determine fair value is not required.²¹¹ As part of its access reform efforts, the Commission can reasonably conclude that revenue-neutral rate changes are appropriate, reasonable and consistent with the public interest. Accordingly, if the Commission decides (as it should) that the AUSF should not be used to offset access charge reductions, there will not be any need for any rate cases or further rulemaking proceedings before the ILECs’ access reductions can be implemented. Rather, the access reductions and any revenue-neutral changes in retail rates can be implemented and processed expeditiously through ordinary tariff filings.

If a particular ILEC can demonstrate that it is not able to reasonably rebalance all

²⁰⁸ Ex. S-1 (Shand Direct) at 28 (Position on Issue No. 7).

²⁰⁹ *Id.*

²¹⁰ Ex. ALECA-2 (Meredith Reply) at 2; Ex. Q-8 (Copeland Reply) at 10 (explaining that “revenue neutral rate changes can take place outside of a fair value rate of return proceeding”).

²¹¹ See *US West Comm. supra* at ¶ 21 (noting that the fair value of a corporation may be important in determining whether rates set too low result in a confiscatory taking of a company’s property).

of its access revenues through increases to its local rates, the Commission could permit that carrier to phase-in the remainder of the rebalancing over a transition period. This would require the ILEC initially to reduce its intrastate switched access rates part-way to the level of Qwest's intrastate rate, and the carrier could offset those reductions with a corresponding amount of local rate increases. Further decreases in the carrier's access rates to Qwest's level would be made under a reasonable transition plan.²¹²

Proceeding in this manner would be far superior to shifting the ILEC's entire existing access revenue stream to the AUSF and allowing ILECs to obtain funding from that source. The latter approach would create an inappropriate "entitlement" mechanism with all of its drawbacks (described below). It would also delay needed access reform, as the Commission would have to initiate a new proceeding and formally adopt new rules to authorize the expansion of the current AUSF to serve this new purpose.

Converting the AUSF into an access charge revenue replacement mechanism as an expedient way to more quickly reduce ILECs' access rates would be bad public policy. Proposals to create an insurance policy for "lost" access revenues and ILEC profits would perpetuate distortions in communication markets, allow ALECA companies to continue recovering a disproportionate amount of their costs from other providers and their customers, inhibit fair and efficient competition, and do nothing to enhance consumer welfare. In particular, such an approach would perpetuate the anticompetitive system of carrier-funded subsidies that this proceeding is intended to reduce. It would wrongly insulate ILECs from the risks and rigors of the competitive market. It would siphon off substantial revenues from other Arizona service providers that are needed to

²¹² See Ex. Q-7 (Copeland Direct) at 7 (suggesting that if local rate increases would be "greater than an amount defined by the Commission," necessary rate changes might be phased in over a multi-year transition period).

properly serve those carriers' own customers in today's competitive market. And, if proposals to expand the base of contributing providers were also adopted, it would shift some of the burden of subsidizing ILECs to entities that would not even benefit from the access charge reductions and have, at most, only a tangential relationship to the rural carriers that would be the beneficiaries of their largesse. Finally, from an administrative standpoint, expanding the AUSF is not the simplest or most efficient solution. Additional time would be needed to conduct a further rulemaking and adopt necessary rule changes. Growing the existing \$769,000 program to a \$23 million fund will also require the development of new processes to handle the collection and distribution of funds, as well as essential auditing tools.

For all these reasons, the Commission should reject all attempts to shift the ILECs' current access revenue stream to a substantially expanded AUSF.

1. ILECs Do Not Have an "Entitlement" to a Guaranteed Revenue Stream

Mr. Meredith testified that "[a]ny state access reduction must be offset with an increase in AUSF and/or local rates."²¹³ However, ALECA did not make any specific recommendations regarding local rate increases and actually opposes the creation of local service benchmarks.²¹⁴ Instead, it argues only that ILECs should be entitled to replace any lost access revenues with funds obtained from a greatly enlarged AUSF.²¹⁵

ALECA's position is based on the assumption that ILECs are entitled to continue

²¹³ Ex. ALECA-2 (Meredith Reply) at Exhibit DDM-R1, p. 3 (Response to Issue No. 10).

²¹⁴ ALECA opposes the adoption of any local rate benchmark; consequently, it only addressed this issue in the event "the Commission finds that local rate increases are considered a necessary element of access reform." See Ex. ALECA-1 (Meredith Direct) at 8 and Ex. ALECA-2 (Meredith Reply) at Exhibit DDM-R1, (Response to Issue No. 6).

²¹⁵ Ex. ALECA-2 (Meredith Reply) at 3, 9.

receiving 100% of the amount they have obtained historically through excessive access charges regardless of any changes taking place in the competitive market.²¹⁶ It also assumes that an ILEC should automatically receive the exact same “fixed” amount every month for the next few years, regardless of any changes in its business or the size of its customer base over time.²¹⁷ If access line loss continues (as current trends would indicate), the ILECs’ “over-recovery” would grow exponentially with each passing year. RUCO’s witness aptly referred to this guaranteed payment plan as a “lump sum entitlement”²¹⁸ Other parties also criticized ALECA’s underlying assumptions and explained that it had failed to justify its position.²¹⁹ There is no factual, legal or policy basis for ALECA’s claim of entitlement, and the Commission should reject it as a basis for moving ahead with access charge reform.

ALECA’s position presumes that every ILEC should be able to retain the substantial subsidies currently generated from access overcharges, but it did not produce any evidence that any ILEC has a need for such revenues. There has not been any review of the financial situation of any ILEC in Arizona (other than Qwest) in more than a decade, so there is no factual basis for making any conclusions about the current financial posture of any ILEC. Mr. Meredith suggested that this prolonged lack of regulatory

²¹⁶ See Ex. ALECA-1 (Meredith Direct) at 8-9 (proposing that ILECs receive disbursements from the AUSF equal to the access revenues they received in 2009 “for at least three years”).

²¹⁷ Tr. at 157-158. ALECA’s proposal to “lock in” 2009 access revenues as the baseline would actually over-compensate the LECs going forward, because it ignores the effects of line loss, which, given recent trends, would cause LEC access revenues to decline in every succeeding year. Ex. VZ-3 (Price Rejoinder) at 18, fn. 38; Tr. at 345; *see also* Ex. ALECA-2 (Meredith Reply) at 10 (admitting that “ALECA member companies have lost access lines to competitors”); Tr. at 489 (ALECA members experienced “double digit” decline in access charge minutes of use between 2002-2008); and Tr. at 179 (“the declining revenues will continue to decline”).

²¹⁸ Tr. at 108-109.

²¹⁹ Ex. VZ-2 (Price Reply) at 19-23; Ex. VZ-3 (Price Rejoinder) at 11-14; Ex. Sprint-3 (Appleby Reply) at 14-15, 20-21; Ex. S-1 (Shand Direct) at 19-20; Ex. JCLEC-1 (Denney Direct) at 11.

oversight should not cause ALECA members to have to justify their existing rates.²²⁰ On the contrary, because it is ALECA that is proposing an extraordinary form of relief – a guaranteed revenue stream for years to come paid for by other service providers – ALECA bears a substantial burden to demonstrate that its proposal is warranted and in the public interest.

Because ALECA's proposal would impose a substantial burden on Arizona consumers, it is only fair and reasonable that the Commission not act on blind trust, but instead that it first examine the carriers' current costs, rates and earnings to determine, as ALJ Rodda put it, "whether they really need it."²²¹ Advancements in technology and communication services have caused the cost of many services to decline over time, and "[t]hese cost trends should facilitate a downward trend in costs for the ALECA members."²²² Commission Staff also suggested that the RLECs' longstanding rates may no longer be appropriate given the numerous changes that have taken place in the companies' businesses over the years.²²³ On the revenue side, there has been no showing that ILECs cannot adequately recover their costs through the prices they charge for their regulated retail services. Nor has any ILEC attempted to demonstrate that some increase in retail prices would make its services unaffordable.²²⁴ AT&T's witness Dr. Aron

²²⁰ Ex. ALECA-2 (Meredith Reply) at 2. ALECA's argument ignores the fact that access rates were not originally set on the basis of cost. Instead, they were set well above the economic cost of providing access services in order to provide a contribution that kept basic local rates artificially low. See Ex. VZ-4 (Price Direct) at 6-7; Ex. VZ-2 (Price Reply) at 43; Tr. at 378-379; Ex. AT&T-1 (Aron Direct) at 22-24.

²²¹ Tr. at 206.

²²² Ex. R-2 (Johnson Rejoinder) at 18-19; Ex. R-1 (Johnson Direct) at 21-22.

²²³ Ex. S-1 (Shand Direct) at 19-20. When asked by ALJ Rodda if the Commission should simply trust the carriers if it "really has no idea" whether the ILECs are overearning, ALECA's witness asserted "it is an uncertainty," because over "five years or 10 years, there are costs that go up, there are costs that go down, there are revenues that go up, revenues that go down." Tr. at 208-209.

²²⁴ See Ex. AT&T-3 (Aron Reply) at 61.

testified that “[i]f a provider has been granted full pricing flexibility on certain lines ... there is no longer any justification for allowing excessive access rates to subsidize those lines... The provider would already have the opportunity to recover its local service costs in the retail market as competition permits.”²²⁵ Thus, in the absence of specific and detailed information about the ILECs’ current costs and earnings, there is no basis on which to conclude that ALECA members require any supplemental funding to offset the decline in access revenues.²²⁶

ALECA did not provide any cogent rationale for its theory that ILECs have an entitlement to these revenues, both now and in future years, or that the Commission should lock in their historical revenue stream for the foreseeable future. ALECA’s proposal to protect the ILECs’ revenue stream by ensuring AUSF funding only for ILECs²²⁷ would protect ALECA members from competitive forces that encourage typical firms to operate as efficiently as possible. RUCO’s witness explained that it would be unsound to guarantee these firms their existing level of revenues and profits “regardless ... of how little effort they make to control their costs.”²²⁸ Furthermore, providing one group of carriers in a competitive market a multi-year revenue guarantee when other providers have no such guarantee (and would have to subsidize the group that does) is not competitively neutral, but “will inevitably distort competition.”²²⁹ Despite criticisms that its proposal would be anti-competitive and discriminatory,²³⁰ ALECA did not respond to

²²⁵ Ex. AT&T-1 (Aron Direct) at 89; *see also* Ex. Sprint-3 (Appleby Reply) at 16.

²²⁶ Ex. VZ-3 (Price Rejoinder) at 11-16; Ex. S-1 (Shand Direct) at 19-20.

²²⁷ Tr. at 212.

²²⁸ Ex. R-2 (Johnson Rejoinder) at 20.

²²⁹ Ex. Cox-1 (Garrett Direct) at 5; Ex. VZ-3 (Price Rejoinder) at 18.

²³⁰ *See* Ex. VZ-3 (Price Rejoinder) at 18-19; Tr. at 109.

or rebut these charges.

2. It Would Be Unreasonable and Bad Policy Simply to Shift Access Charge Revenues to a Guaranteed Funding Stream From the AUSF

To achieve its goal of guaranteed revenue neutrality, ALECA proposes to shift the ILECs' intrastate access revenues from the existing intrastate access charge regime to the AUSF "high cost program." ALECA projects that once ILECs reduce their access rates to the level of Qwest's intrastate rate, the amount of AUSF support that would be funneled to its members each year would be approximately \$23 million, based on 2008 revenue and usage data.²³¹

RUCO's witness disagreed with ALECA's assumption "that it is appropriate on a dollar-for-dollar basis to push onto the AUSF the lost revenues that would result" from access charge reform.²³² Shifting the recovery of subsidies from access charges to the AUSF merely changes the way the subsidies are collected from customers. However, the anti-competitive and anti-consumer problems that result from allowing ILECs to collect too much revenue from other carriers through their high switched access rates would not be remedied by allowing the ILECs to collect the same revenue from other carriers in a different way through the AUSF.²³³

Expanding the AUSF to preserve a historic revenue stream would encourage ILECs to continue relying on artificial subsidies, which is not appropriate in a competitive environment.²³⁴ The ILECs should actually be reducing their dependence on

²³¹ Ex. ALECA-1 (Meredith Direct) at 8-9. The size of the fund would be substantially greater if AT&T's proposal to reduce ILECs' intrastate access rates to their interstate level were adopted.

²³² Tr. at 79.

²³³ Ex. Sprint-3 (Appleby Reply) at 15; Ex. VZ-4 (Price Direct) at 18.

²³⁴ Ex. VZ-2 (Price Reply) at 19.

revenue from other carriers, not simply shifting that burden from access rates to another carrier-funded source such as the state's AUSF. RUCO's witness testified that granting ILECs exclusive access to an expanded AUSF would, in addition, "largely insulate them from pressures to operate as efficiently as possible, to adopt cost-effective new technologies, and to improve their work processes."²³⁵ On the other hand, Sprint's witness observed that "[a]llowing LECs to recover revenue from their own end user services exposes that revenue to the rigors and efficiency of competition."²³⁶

Significantly, ALECA did not respond to these substantive criticisms. Instead, it offered a rationale for its proposal that merely confirmed its self-serving nature. The companies' witness testified that

[i]t would be sound public policy to permit ALECA members to shift intrastate access revenues from the current intrastate access-charge regime to a revenue-neutral AUSF mechanism *without the economic and administrative burdens associated with an intrastate rate case*. This maximizes the public benefit, while *minimizing the burden on ALECA members*.

It would not be sound public policy to delay the public benefit of access reform and *require each ALECA member to endure a costly and time consuming rate case* to perform a revenue-neutral shift in revenues.²³⁷

It is clear from these passages that ALECA's primary motivation for automatically shifting all foregone access revenues to the AUSF is the ILECs' desire to avoid any responsibility for demonstrating that they should be guaranteed the ability to continue receiving their historical revenue streams for years to come. There is no doubt that this approach would be quite beneficial to ILECs: they would be free of any administrative obligations and would no longer have to be concerned about declining

²³⁵ Ex. R-2 (Johnson Rejoinder) at 19.

²³⁶ Ex. Sprint-1 (Appleby Direct) at 22.

²³⁷ Ex. ALECA-2 (Meredith Reply) at 3 (emphasis added).

access revenues. But ALECA failed to explain how ensuring this exclusive private benefit “maximizes the public benefit” or is “sound public policy.” In fact, it is neither.

The supposed “administrative burden” on ALECA members should be balanced with the financial burden that ALECA’s proposal would impose on Arizona’s communications carriers and users. In fact, the new arrangement contemplated by ALECA would not benefit Arizona consumers, including low-income customers in urban areas,²³⁸ who would be forced to continue paying the historic excessive charges, albeit via a different surcharge mechanism. ALECA’s proposal would penalize those consumers who, in the competitive market, have availed themselves of service alternatives to the ALECA member companies’ services. The end user customers of other carriers should not be burdened with supporting the ILECs’ operations when the ILECs are not charging their retail customers rates commensurate with either the costs of their local services or the rates charged to other Arizona consumers for comparable services.²³⁹ By continuing to collect existing overcharges from the ILECs’ competitors, the ALECA plan would not alter the adverse impact on the contributing carriers, because they would have less money to spend serving their own customers. Nor would the ALECA plan alter the adverse impact on the ILECs’ customers, as they would still face diminished opportunities for competitive alternatives. And ILECs would continue to have diminished incentives to engage in service, product and network innovation.

There is no evidence in the record that any ILEC has a demonstrated need for additional funding to compensate it for access charge reductions beyond what it can

²³⁸ See Ex. AT&T-1 (Aron Direct) at 99-100; Ex. AT&T-3 (Aron Reply) at 64-65.

²³⁹ Ex. Q-7 (Copeland Direct) at 4.

generate by raising retail rates.²⁴⁰ Staff pointed out that ALECA's position is based instead only on "anecdotal statements of need."²⁴¹ Several parties emphasized the importance of ensuring that any supplemental funding is actually needed before proceeding to an examination of how much support might be appropriate, what other revenue sources are available, and from what entities should any additional funds be collected.²⁴² Qwest also explained that, as part of that review, the ILEC should be required to demonstrate it is charging appropriate and fair rates to its end user customers, and submit to an earnings review.²⁴³

For all these reasons, ALECA's proposal to simply shift 100% of the access revenue reduction to the AUSF and to use the AUSF as a substitute funding source for its members is unreasonable, unjustified and contrary to the public interest.

None of these problems would be overcome by Staff's alternative proposal to grant carriers "temporary" AUSF support.²⁴⁴ Under this scenario, a new surcharge would be imposed on other carriers at the outset to compensate an ILEC for 100% of its access charge reduction. Twelve months after the Commission grants an ILEC "temporary AUSF support," the carrier would be required to file a rate case or rate review. Due to

²⁴⁰ A.A.C. R14-2-1203 provides that a local exchange carrier may request that "the Commission authorize AUSF support with a filing under R14-2-103 or other method as the Commission may prescribe, and upon compliance with all applicable rules set forth in R14-2-1101 through R14-2-1115. *A request for AUSF support shall include a statement describing the need for such funding.* The Commission shall determine the appropriate cost of providing basic local exchange service for each AUSF support area for which AUSF support is requested and shall calculate in accordance with R14-2-1202 the amount of AUSF support, if any, to which the applicant is entitled." (Emphasis added.) ALECA did not explain why its members should be allowed to short-circuit this existing process, or why the Commission should abrogate its responsibilities under this section and instead simply grant the ILECs' request for full recovery of their foregone access revenues.

²⁴¹ Ex. S-1 (Shand Direct) at 19.

²⁴² *Id.* at 20; Tr. at 719; Ex. Sprint-3 (Appleby Reply) at 15; Tr. at 467; Ex. Q-7 (Copeland Direct) at 4-6.

²⁴³ Ex. Q-7 (Copeland Direct) at 4-6; Ex. Q-8 (Copeland Reply) at 4-5.

²⁴⁴ Ex. S-1 (Shand Direct) at 27 and Ex. S-2 (Errata).

“resource constraints,” these cases would be commenced on a staggered basis over the following 3-1/2 years (*i.e.*, 42 months after the Commission’s decision awarding “temporary” support). Because additional time would be needed to actually conduct and complete the rate review for each carrier, it would be several years before the “temporary” AUSF support to ALECA members could be terminated.

This alternative contains all of the drawbacks of the ALECA proposal and offers no compensating benefits. ILECs would escape any responsibility to look to their own customers rather than their competitors for any needed funds. In this regard, the Commission should recognize that the significant intermodal competition that exists in Arizona serves to limit the rates that competitors can charge, so a market mechanism is already in place that ensures retail customers have access to services at reasonable rates. In addition, a “temporary” fund could take on a life of its own and be extremely difficult to dissolve. Any delays in processing the numerous rate reviews would simply prolong the situation. Because consumers would bear the burden of any expanded AUSF, it is unreasonable to impose such a burden without any evidence demonstrating it is required, and without imposing strict constraints on the fund.²⁴⁵

3. Creating a New Access Charge Recovery Mechanism Is Not Consistent With the Stated Purpose of the AUSF

ALECA’s proposed dollar-for-dollar shift of revenue from access charges to the AUSF would increase the contribution burden on Arizona’s consumers and expand that program beyond its intended purpose. The Commission has explained that “[t]he AUSF was established to maintain statewide average rates and the availability of basic telephone

²⁴⁵ Ex. VZ-2 (Price Reply) at 32; Ex. Cox-1 (Garrett Direct) at 9 (arguing that any transitional support should “sunset” after a specified period of time).

service to the greatest extent reasonably possible.”²⁴⁶ The Commission also observed that the purpose of the AUSF is to “ameliorate the upward pressure on basic local rates in rural areas” and “assure that the high cost of providing wireline local exchange service in rural areas will not diminish the availability of affordable service.”²⁴⁷ ALECA’s proposal to convert the current “high cost” fund into an “access recovery mechanism” is a far cry from these original purposes.²⁴⁸

ALECA disagrees that its proposal to expand the AUSF is inconsistent with the original purposes of the high cost fund. However, both ALECA and other parties acknowledge that the current AUSF rules would have to be changed to permit its proposal to take effect.²⁴⁹

ALECA testified that “[t]he purpose of the AUSF is to keep local rates from exceeding an affordable local benchmark as determined by the Commission.”²⁵⁰ Ironically, ALECA opposes proposals to establish any benchmarks for local service rates. Nevertheless, ALECA claims that its proposal to allow for a revenue neutral draw of support from the AUSF would “keep local rates affordable,” “enable rural carriers to continue investing and maintaining local exchange facilities in these high-cost areas,” and

²⁴⁶ *Notice of Proposed Amendments to the Arizona Universal Service Fund*, Decision No. 70659, Order, Docket No. RT-00000H-97-0137 (Dec. 22, 2008) at 1; *see also* Decision No. 63267 (same docket) (Dec. 15, 2000) at 1.

²⁴⁷ *Application of Arizona Telephone Company for Approval of the Arizona Unity Plan, et al.*, Decision No. 56639, Docket No. U-2063-87-290 *et al.* (Sept. 22, 1989) at 5, 32.

²⁴⁸ The Commission Staff agreed with ALJ Rodda that ALECA’s proposal would constitute an expansion in the role and amount of the existing fund. Tr. at 707.

²⁴⁹ Ex. ALECA-2 (Meredith Reply) at Exhibit DDM-R1 (Response to Issue No. 3); Tr. at 194-195; Ex. AT&T-7 (Oyefusi Direct) at 10, 71; Ex. AT&T-9 (Oyefusi Reply) at 21 (the “current rules do not clearly authorize the use of AUSF support to recover reductions in access revenues, nor are they designed to fund support for this purpose”); Tr. at 296, 442.

²⁵⁰ Ex. ALECA-2 (Meredith Reply) at 9.

keep rural customers on the network.”²⁵¹ The record does not substantiate these claims and the assumptions that underlie them.

The record contains evidence of a number of developments, including the rise of competition, technological innovation, and the proliferation of intermodal service providers, that have dramatically altered the communications landscape. These developments give rise to questions about the continuing vitality of broad-based subsidy programs and whether the existing high-cost program should be expanded in the way envisioned by ALECA.

AT&T’s witnesses presented evidence that both wireless and broadband services are widely available, even in rural areas of Arizona. For example, by mid-2008, 97 percent of Arizona residents over the age of 15 had a wireless phone.²⁵² Even prior to then, the Commission indicated that “there is significant CLEC-based competition as well as ‘intermodal’ wireless and VoIP alternatives in Arizona.”²⁵³ These service and technological developments have driven down the costs associated with providing basic communication services in rural areas. This has resulted in greater choice and lower rates for consumers. Because consumers increasingly have access to quality services that are provided by a number of competing carriers and alternative technologies at affordable rates, the historical assumption that broad based subsidies are needed to keep residential rates artificially low may no longer be valid and should be carefully scrutinized.²⁵⁴ Also, because the current support system was established in the context of a single ubiquitous

²⁵¹ *Id.* at 9 and Exhibit DDM-R1 (Response to Issue No. 5).

²⁵² Ex. AT&T-7 (Oyefusi Direct) at 32-33; *see also* Ex. AT&T-1 (Aron Direct) at 94-96.

²⁵³ *Qwest Corporation’s Filing of Renewed Price Regulation Plan*, Decision No. 68604, Opinion and Order, Docket No. T-01051B-03-0454 (March 23, 2006) at 15-16.

²⁵⁴ Ex. VZ-2 (Price Reply) at 20-23; Tr. at 377-382.

wire-line network, that rationale makes less sense in an environment where consumers have access to multiple suppliers using alternative technologies.²⁵⁵

ALECA's proposal to use the AUSF as a replacement mechanism for access revenues ignores these dramatic changes in the communications landscape, and merely assumes that all of the historic conditions that originally supported the rationale for broad based universal service funding still exist today. ALECA's proposal for ILEC-provided wireline local exchange service to be subsidized incorrectly assumes that "universal service" requires access to a traditional landline phone. Similarly, there is no evidence to support the notion that without granting a new, explicit subsidy to the ALECA member companies, consumers in rural areas will not be able to obtain access to basic telephone service at affordable rates from either an ALECA member or some other provider. Finally, the assumption that the costs of providing service in rural areas remains prohibitively high has not been examined in years; it ignores the technological advancements described in the record, and cannot be substantiated absent a showing that a particular RLEC serving a designated area actually faces high costs.²⁵⁶

Verizon's witness Mr. Price explained that a broad based subsidy program such as that advocated by ALECA tends "to do more harm than good."²⁵⁷ In this case, the plan would encourage ILECs to continue relying on artificial subsidies, which is not appropriate in a competitive environment, and without demonstrating that any carrier has

²⁵⁵ Tr. at 380, 540.

²⁵⁶ Ex. VZ-2 (Price Reply) at 22; Tr. at 379, 381-382.

²⁵⁷ Tr. at 382; *see also* Tr. at 381, 384 (explaining that targeted programs that are designed to provide specific benefits to people who are otherwise incapable of obtaining basic local telephone service is a superior approach); Ex. Q-7 (Copeland Direct) at 4 (describing advantages of providing targeted support to discrete areas). While it opposes expansion of the AUSF to recover reduced access revenues, Sprint argued that any new subsidy amount should be set on a per line basis, any additional funding should be limited, and ILECs should receive funding from the AUSF only on residential lines "when the customer purchases standalone basic local service from the ILEC." Ex. Sprint-3 (Appleby Reply) at 3, 19.

a specific need for the supplemental funding. Dr. Aron also explained that the larger the draw from the fund, “the greater is the economic inefficiency and cost to society caused by distorted competition, distorted consumption decisions by consumers, and distorted incentives for investment by providers.”²⁵⁸ ALECA’s proposal would perpetuate the anticompetitive status quo by requiring other carriers to continue funding the ILECs’ competitive operations. Rather than create “public benefit,” the expanded subsidy program would penalize customers that have already availed themselves of other competitive service options.²⁵⁹ None of these outcomes would further the original goals of the AUSF.

There are additional reasons why ALECA’s proposal is unsound. ALECA’s stated purpose is to provide ILECs with a revenue guarantee by replacing access revenues, dollar-for-dollar, with funds from an expanded AUSF. Because no other service providers would obtain the same benefit, the proposal is not competitively neutral. RUCO argues against making AUSF support available only to ILECs, and suggests instead that any support be transferrable, *i.e.*, the support would follow a customer when a customer changes carriers.²⁶⁰ But if funding were made portable and provided to another carrier that wins a customer away from an ALECA member, the mechanism would not serve the purpose intended by ALECA (to guarantee the ILEC’s revenues), because those revenues can be “competed away” by other carriers. While this approach may be attractive because it would direct support based on the requirements of serving particular customers and would promote the policy goal of competitive neutrality,

²⁵⁸ Ex. AT&T-1 (Aron Direct) at 101.

²⁵⁹ Ex. VZ-2 (Price Reply) at 22-23.

²⁶⁰ Ex. R-1 (Johnson Direct) at 52-53; *see also* Ex. S-4 (Shand Reply) at 4.

it would not be appropriate to permit CLECs that have significant pricing flexibility and no legacy obligations to draw from a “universal service” fund. To serve the purpose intended by ALECA, the expanded AUSF must be explicitly discriminatory rather than competitively neutral. Thus, there is a conflict between the policy goal of making funds portable, and therefore, competitively neutral, and ALECA’s objective of making its members whole.²⁶¹ This further highlights why ALECA’s proposal does not provide a basis for rational policy making.

For the foregoing reasons, it would not be “sound policy” for the Commission to pursue ALECA’s misguided proposal. The Commission should reject proposals to use the AUSF as a replacement vehicle for preserving access revenues, and instead require all local exchange carriers to recover their costs primarily from their own retail customers.

If the Commission disregards Verizon’s recommendations and decides to allow individual carriers to receive support from the AUSF as compensation for foregone access revenues, it should impose strict pre-conditions before permitting them to do so. A carrier seeking recovery from the AUSF should first be required to increase its local rates to an appropriate Commission-set benchmark (discussed below). The carrier should also be required to demonstrate through a factual showing that it cannot recover lost access revenues through revised retail rates, and that it cannot continue to provide basic local service in a specific area without continuing to receive a subsidy. The Commission should also make clear that this would be a temporary support mechanism only. The AUSF should not be converted to a permanent access revenue replacement fund. Instead, the Commission should cap the size of the AUSF and set an end date for the availability of temporary AUSF subsidies, terminating them completely no more than three years

²⁶¹ Ex. VZ-3 (Price Rejoinder) at 18-19.

after their initiation.

D. The Commission Should Establish a Benchmark for Local Service Rates

All CLECs and ILECs should be afforded ample pricing flexibility to enable the carriers to adjust their rates for retail services to offset any revenue declines they experience when their access rates are lowered to Qwest's intrastate rate. Several parties recommend that the Commission also establish a local rate benchmark that would provide guidance as to the level of local rates that would be appropriate. The benchmark would constitute a reasonable and affordable rate, and a carrier could raise its rates for basic local residential service to the benchmark. Stated another way, a benchmark would allow as much cost recovery from end users as possible, subject to affordability concerns.²⁶² Any ILEC with rates below the benchmark would be required to increase its local rates to that level as part of any rate rebalancing that occurs when it reduces its access rates.²⁶³ This would not result in an overall net revenue increase for the carrier, so no earnings review or rate case should be necessary before the local rate changes are made.²⁶⁴ Establishing a local rate benchmark therefore makes sense even if the Commission decides not to use the AUSF as an access revenue replacement mechanism.²⁶⁵

Every party but one that addressed this issue supported the adoption of a single local rate benchmark that would apply statewide and opposed the creation of company-

²⁶² Ex. AT&T-7 (Oyefusi Direct) at 55.

²⁶³ If setting basic local exchange rates at the benchmark allows an ILEC to recover its reduced intrastate access revenues in a revenue neutral manner, questions about AUSF support never arise. Ex. Q-7 (Copeland Direct) at 5.

²⁶⁴ Ex. ALECA-2 (Meredith Reply) at Exhibit DDM-R1 (Response to Issue No. 6).

²⁶⁵ If the Commission were to permit an ILEC to obtain funding from the AUSF to offset access reductions (which would be bad policy), the ILEC should first be required to raise its local rates to the benchmark before it is allowed to draw from the fund. Ex. Q-7 (Copeland Direct) at 5.

specific benchmarks.²⁶⁶ The benefits of establishing a single uniform standard that would apply statewide are clear. According to Sprint, the public policy goal of universal service is to set local service rates at a level deemed affordable, and the benchmark simply sets that affordability standard for all consumers in Arizona. “Setting a benchmark on a statewide level also protects the interests of Arizona consumers living in higher cost areas who could be expected to pay more than consumers in lower cost urban areas.”²⁶⁷

On the other hand, the Commission Staff proposed that each ILEC file a rate case in which the Commission would determine, among other things, the residential local exchange rates that would be reasonable for that carrier.²⁶⁸ Staff’s position appears to be based on the fact that there is a wide range in local exchange rates charged by ILECs in Arizona and an assumption that this might be due to differences in the carriers’ costs.²⁶⁹ Staff did not try to validate this assumption, however, which was surprising given its acknowledgment that the Commission has not examined any rural LEC’s costs in more than ten years. More important, Staff did not explain how its proposal, which could result in a multitude of different local service rates, would satisfy the policy objective that local rates should be affordable. In particular, it did not explain how affordability might be affected by an individual carrier’s costs or why affordability might vary across different parts of the state.

Use of a statewide benchmark is clearly superior to Staff’s proposal because it is

²⁶⁶ *Id.* at 4; Ex. Q-8 (Copeland Reply) at 4; Ex. AT&T-7 (Oyefusi Direct) at 56; Ex. AT&T-3 (Aron Reply) at 64-65; Ex. Sprint-1 (Appleby Direct) at 21; Ex. Sprint-3 (Appleby Reply) at 12-13; *see also* Tr. at 246 (Cox recommending use of a national benchmark).

²⁶⁷ Ex. Sprint-3 (Appleby Reply) at 13.

²⁶⁸ Ex. S-1 (Shand Direct) at 18.

²⁶⁹ *Id.* at 16.

more equitable and gives the correct economic signals.²⁷⁰ Adopting a single, statewide benchmark would establish a minimum acceptable level for end user charges that could be followed in any future proceeding involving individual carriers. Implementing a statewide standard also would be more administratively efficient than conducting multiple rate cases, as would be required if Staff's proposal were pursued. Staff suggests that a R14-2-103 filing by each ILEC would be necessary to ensure that the new local rates are just and reasonable, but that objective would be met more efficiently by establishing a single benchmark that would apply statewide. Staff's proposed solution would be unnecessarily complex and time-consuming.²⁷¹

The proposal for a statewide benchmark is also more consistent with the manner in which the federal universal service program is operated. The federal Telecommunications Act provides that "[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services ... that are available at rates that are reasonably comparable to those services provided in urban areas."²⁷² Because one of the goals of the program is to limit the gap between rates in rural and urban areas, a more uniform rate better achieves that objective. Finally, in administering this provision, the FCC evaluates rates for comparability on a national and statewide basis, and does not perform a granular review of the costs of individual carriers, unlike the more painstaking approach Staff proposes to undertake here.²⁷³

²⁷⁰ Tr. at 441.

²⁷¹ Ex. AT&T-9 (Oyefusi Reply) at 38-39.

²⁷² 47 U.S.C. § 254(b)(3).

²⁷³ See *High-Cost Universal Service Support*, FCC 10-56, WC Docket No. 05-337, CC Docket No. 96-45 (April 16, 2010).

As of 2007, the national average residential basic local service rate was \$15.62 per month, which is considerably higher than the average local residential rate charged by ALECA members, \$12.91, and Qwest's current monthly residential local service rate of \$13.18.²⁷⁴ The record contains several specific proposals for a statewide local benchmark that might be adopted. For example, Qwest recommends that the residential local service rate benchmark be set at 125% of the current statewide average local rate, or \$16.48 per month.²⁷⁵ AT&T proposes a benchmark of approximately \$17.50.²⁷⁶ Sprint generally supports the AT&T proposal, and notes that other states have set higher benchmarks.²⁷⁷ While ALECA opposes the establishment of any local benchmarks, it argues that if the Commission adopts one, it should be set at \$11.84 per month, which is below the current statewide average rate.²⁷⁸ Parties also recommended that a separate benchmark for single-line business rates be established and that the benchmarks be adjusted over time.²⁷⁹

As Qwest pointed out, the statewide benchmark needs to be set through a process in which the Commission considers the affordability of specific rates.²⁸⁰ Accordingly, it is not necessary to decide at this time where the benchmark should be set. In its order concluding this proceeding, the Commission can make a preliminary decision that it

²⁷⁴ Ex. Sprint-1 (Appleby Direct) at 21; Ex. Q-7 (Copeland Direct) at 6; Ex. ALECA-2 (Meredith Reply) at 6-7.

²⁷⁵ Ex. Q-7 (Copeland Direct) at 5-6.

²⁷⁶ Ex. AT&T-7 (Oyefusi Direct) at 59-60.

²⁷⁷ Ex. Sprint-3 (Appleby Reply) at 13.

²⁷⁸ Ex. ALECA-2 (Meredith Reply) at Exhibit DDM-R1 (Response to Issue No. 6). ALECA's objection to any local rate benchmark stems from its contention that ILECs should be able to automatically receive money from an expanded AUSF on an expedited basis without any pre-conditions and without making any showing whatsoever. *See id.* at 11.

²⁷⁹ *See* Ex. Q-7 (Copeland Direct) at 4; Ex. Sprint-3 (Appleby Reply) at 14; Ex. AT&T-7 (Oyefusi Direct) at 57.

²⁸⁰ Ex. Q-8 (Copeland Reply) at 4; Tr. at 449 (pointing out that the existing rules already refer to "benchmarks," and noting that the Commission has not yet adopted any).

intends to establish a local rate benchmark, and then immediately commence a separate proceeding for the purpose of resolving that issue. Given the information that is already available and the fact that the FCC and other state regulators have already addressed the issue of local benchmarks,²⁸¹ the Commission should be able to conduct that follow-on proceeding expeditiously, and apply the results immediately thereafter.

V. THE PROCESS FOR IMPLEMENTING VERIZON'S RECOMMENDATIONS FOR ACCESS CHARGE REFORM

A. The Process for Reducing CLEC Access Rates

Verizon's benchmark proposal would require each CLEC to reduce its intrastate switched access rates to be no higher than Qwest's intrastate rate, and CLECs would have the ability to adjust their retail rates to offset any reduced revenues from their switched access services. So long as the revenues generated from any retail price increases do not exceed the amount of access revenue reductions (and the CLEC has sufficient room within its existing maximum rates to accomplish the rate increases), a CLEC should be allowed to implement these rate changes quickly. If a revenue neutral rate rebalancing requires a revision to (or setting of) maximum rates, the CLEC should be allowed to make such revisions in an expeditious manner in accordance with AAC R14-2-1110.

These policies should be implemented as follows:

- In its order issued at the conclusion of this proceeding, the Commission should establish a policy, creating a price cap for CLEC switched access services. The Commission should set the cap based on the intrastate switched access rates of Qwest. Under this policy, (1) a CLEC may not charge intrastate switched access rates above Qwest's composite rate, and (2) a

²⁸¹ See Ex. AT&T-7 (Oyefusi Direct) at 60.

CLEC may only include charges for the functions that the CLEC actually performs in providing its switched access service. (The text of the proposed rule is set forth on page 27 above). Except as discussed below, rates that do not exceed the benchmark will be presumed to be just and reasonable.

- To ensure compliance with this new policy, the Commission's order should direct that if a CLEC's current intrastate access rates comply with the new cap, it shall file, within 30 days, a sworn affidavit attesting that its current intrastate switched access tariff is in compliance with the Commission's order.
- The Commission's order should also direct that if a CLEC's current intrastate access rates do not comply with the new cap, the carrier shall file, within 30 days, revisions to its intrastate switched access tariff that comply with the order, bearing an effective date no later than 30 days after the filing, and a sworn affidavit attesting that the new intrastate switched access rates comply with the order.
- The Commission should rule that any CLEC whose switched access rates are lower than the benchmark may not increase them.²⁸²
- The Commission's order should permit any CLEC that is required to file revisions to its intrastate switched access tariff as a result of the order to quantify the revenue reduction associated with the required access reductions and allow the CLEC to propose changes to its tariffs for retail services to offset those lost revenues, if the CLEC chooses to do so. All such changes to retail rates may take effect 30 days after filing without any additional action

²⁸² See Tr. at 62 (RUCO witness agreeing with Staff's position that if a LEC's current rate is below the benchmark, it should be required to keep the lower rate in place.)

by the Commission.²⁸³

- If, in implementing any of the revenue neutral rate changes described above, a CLEC's new rate for a retail service would exceed the maximum rate specified in its current tariff, the Commission should permit the carrier to modify the range of rates and set a new maximum rate.²⁸⁴
- The requirements above are continuing in nature. If Qwest's intrastate switched access rates are reduced in the future, within 30 days thereafter, all CLECs must file revisions to their intrastate switched access tariffs, if necessary, to conform to the access rate benchmark.
- The Commission should retain jurisdiction to investigate and compel compliance with the order.
- The Commission should rule that CLECs may enter into contracts to provide switched access service at rates and terms that differ from those in their tariffs. A CLEC must modify its tariffs, if necessary, to allow for such agreements. The Commission should require CLECs to file any such contracts with the Commission within 30 days after the agreement is executed. The CLEC may redact from the document(s) filed with the Commission commercially sensitive information, such as customer information, settlement amounts and

²⁸³ This process is consistent with Arizona Rules R14-2-1109 and R14-2-1110, which permit a telecommunications company to change the price for a competitive service. There is no possibility that increasing a CLEC's existing rate for a competitive service would result in a rate that is "less than the company's total service long-run incremental cost of providing the service," which is the only substantive condition on rate changes that appears in AAC R14-2-1109.

²⁸⁴ This process is consistent with AAC R14-2-1110, which permits a telecommunications company to apply for an increase in any rate for a competitive service and to increase the maximum tariffed rate for any such service. Subpart C of the rule authorizes the Commission to "act on the requested rate increase ... in an expeditious manner." Requiring Commission approval of a revenue neutral rate change within 30 days is consistent with the stated objective that the Commission act expeditiously.

specific service addresses, as well as non-jurisdictional services that may be included in the contract.²⁸⁵ The Commission should require CLECs to make the same contractual terms available to all similarly situated carriers.

B. The Process for Reducing ILEC Access Rates

Verizon's recommendations for reforming the access charges of ILECs in Arizona may be implemented as follows:

- In its order issued at the conclusion of this proceeding, the Commission should establish a policy setting a uniform rate benchmark and, subject to the conditions set forth below, require all ILECs to set their intrastate switched access rates at a level no higher than the composite of Qwest's intrastate switched access rates. Switched access rates that do not exceed the benchmark will be presumed to be just and reasonable.
- The Commission's order should permit any ILEC to propose retail tariff changes to offset the reduction in its access revenues. All such changes to retail rates may take effect 60 days after filing without any additional action by the Commission.²⁸⁶
- The Commission should immediately commence a new proceeding to establish rate benchmarks for the ILECs' residential and business local exchange services that are deemed just, reasonable and affordable. The Commission should commit to complete the proceeding within six months.

²⁸⁵ See Ex. Cox-2 (Garrett Reply) at 8.

²⁸⁶ This process is consistent with Arizona Rules R14-2-1109 and R14-2-1110, which permit a telecommunications company to change the price for a competitive service. There is no possibility that increasing an ILEC's existing rate for a competitive service would result in a rate that is "less than the company's total service long-run incremental cost of providing the service," which is the only substantive condition on rate changes that appears in R14-2-1109.

- If an ILEC's existing residential and business local service rates are below the local rate benchmarks established by the Commission, the ILEC shall file revisions to its tariffs, if necessary, to conform to the new benchmarks. The tariff changes must be filed no later than 30 days after the Commission issues its order establishing the benchmarks, and the rate changes will take effect within 60 days after filing without further action by the Commission
- Each ILEC shall determine the amount of increased revenue it will receive by implementing the local rate increases described above. Concurrent with the filing of revisions to its local service tariffs, each ILEC must file revisions to its switched access charge tariffs and reduce its intrastate access rates by no less than the amount needed to achieve a revenue neutral result. The access charge reductions will take effect within 60 days after filing without further action by the Commission.
- If the access charge reductions implemented by an ILEC pursuant to the foregoing procedures do not result in rates that are at or below Qwest's composite intrastate switched access rate, the ILEC shall promptly submit for the Commission's approval a transition plan for moving its access rates closer to Qwest's intrastate rates in a reasonable period of time, *i.e.*, no more than three years. The ILEC should be required to reduce its access rates by an equal amount annually during the transition period (*e.g.*, one-third of the difference between the carrier's rates at the beginning of the transition and Qwest's intrastate rates, each year, if the transition period is three years). The proposed transition plan should be subject to public comment and

Commission review. The Commission should approve an appropriate transition plan within six months after it is submitted.

- The requirements above are continuing in nature. If the local rate benchmarks are increased in the future, within 30 days thereafter, all ILECs must file revisions to their intrastate tariffs, if necessary, to conform to the applicable rate benchmarks.
- The Commission should retain jurisdiction to investigate and compel compliance with the order.

VI. A REQUIREMENT THAT IXCS DEMONSTRATE HOW ACCESS CHARGE REDUCTIONS ARE PASSED THROUGH TO CUSTOMERS IS UNNECESSARY AND IMPRACTICAL

Staff recommends that interexchange carriers should be required to make a filing with the Commission showing that they have passed through to end users the access charge savings they experience as a result of access charge reductions that result from this proceeding.²⁸⁷ However, the record provides no justification or need for such a rule nor is there any evidence demonstrating how it could be implemented. In fact, such a requirement is both unwarranted and impractical.

The record is clear that reducing intrastate access rates in Arizona will enhance competition in the long distance market and thereby benefit consumers. Competition in the interexchange market will ensure that retail long distance rates include the effects of access cost savings, without the need for a compulsory "flow through" requirement. This is because of the simple truth that in a competitive market, long distance carriers that refuse to pass along the benefits of cost savings will lose customers to those that do.

²⁸⁷ Ex. S-1 (Shand Direct) at 13.

In such a highly competitive market, there is no need for the Commission to impose a rigid flow-through requirement that would constrain the ways in which customer benefits can occur. For example, cost savings may be reflected in reduced rates, or in rates that stay the same because the savings have offset other cost increases, or in a smaller rate increase than otherwise would have been implemented.²⁸⁸ In addition, competitors may choose to invest the savings in advanced technology, improved service quality or customer service, or they could introduce new services or features, thereby bringing tangible benefits to consumers in other ways. Because competition will ensure that such benefits are passed along to consumers in one way or another, there is no need for regulatory intervention.

Also, given the wide variety of rate plans and the different ways in which consumers pay for retail interexchange services (*e.g.*, as one component of a bundled service package, flat-rate, per minute, or a combination thereof, or, as part of a contract containing a number of services offered to business customers on a multi-state basis), it would be impractical to impose any sort of flow-through requirement.²⁸⁹ Significantly, Staff did not explain how such a concept could be implemented or enforced.

Finally, a flow through requirement would be unprecedented. The Commission did not previously impose a “flow through” obligation when Qwest’s intrastate switched access rates were reduced, and there is no reason for the Commission to depart from that policy here.

²⁸⁸ Ex. VZ-2 (Price Reply) at 35-36; Ex. AT&T-3 (Aron Reply) at 87.

²⁸⁹ Ex. VZ-2 (Price Reply) at 36; Tr. at 302-304.

VII. MISCELLANEOUS AUSF ISSUES

A. The Commission Should Reject Proposals to Expand the AUSF to Provide High Cost Loop Funding Support and Fund the Administration of Lifeline and Link-Up Programs

In addition to transforming the AUSF into a mechanism for replacing access revenues, ALECA would enlarge the existing fund in other ways as well. It proposes to expand the AUSF to provide additional financial support for “high cost loops” in order to supplement the amounts that are currently made available to local exchange carriers through a federal program. Based on 2007 data, ALECA estimates that this proposal would increase the size of the AUSF by \$9 million each year.²⁹⁰ ALECA also asks that the AUSF assume the costs of administering Lifeline and Link-Up programs in Arizona. None of these proposals is warranted and the Commission should reject them.

ALECA’s testimony suggests that additional high-cost support is “needed for access reform”²⁹¹ but, in fact, there is no clear nexus between the two concepts, which are quite distinct. ALECA did not explain how its access charge reform proposal – which it admits is “unique to Arizona”²⁹² – would cause any of its members’ status under the federal high-cost program to change.²⁹³ In reality, ALECA is asking the Commission to create an entirely new fund, and impose additional burdens on all Arizona consumers, without providing any evidence that the costs at issue are not already being recovered through other rates, without providing any justification, and without attempting to tie its proposal to actual universal service needs.²⁹⁴ No other party supported such a radical

²⁹⁰ Ex. ALECA-1 (Meredith Direct) at 11.

²⁹¹ Ex. ALECA-1 (Meredith Direct) at 8.

²⁹² Tr. at 190.

²⁹³ See Ex. AT&T-9 (Oyefusi Reply) at 21-22.

²⁹⁴ Ex. VZ-2 (Price Reply) at 37.

expansion of the current fund for this purpose. Based on its concerns, Staff recommended that the Commission take no action on the ALECA proposal at this time and instead await further action by federal authorities with respect to the federal funding mechanism.²⁹⁵ Verizon agrees that ALECA's proposal is not justified and should not be adopted.

Similarly, the Commission should reject ALECA's proposal to use AUSF funds to cover certain costs of Lifeline and Link-up programs. Those programs are not related to access charge reform and, as Staff testified, it is more appropriate that they be funded by the beneficiaries of the programs.²⁹⁶

B. There Is No Justification for Expanding the Base of Contributors to the AUSF to Include the Providers of Wireless and VoIP Services

To generate the massive additional funds needed to implement their expensive proposals to expand the AUSF program for new purposes, the proponents also seek to increase the number and types of service providers that would be required to contribute to such programs and share the significantly higher costs their plans would demand.

ALECA asks specifically that wireless carriers and VoIP service providers help fund its ambitious, expensive proposals to use the AUSF as a source of replacing access revenues, high cost loop support and administering Lifeline and Link-up programs.²⁹⁷

²⁹⁵ Ex. S-1 (Shand Direct) at 22-23.

²⁹⁶ Ex. AT&T-9 (Oyefusi Reply) at 22; Ex. S-1 (Shand Direct) at 26. If the Commission decides to modify the AUSF rules, Verizon recommends that it make two minor changes. First, it should eliminate R14-2-1206 (E) to make clear that support is only available to one carrier in a given area. Second, it should incorporate a *de minimis* exception that relieves carriers whose AUSF assessment would be less than \$500 per month from contributing to the fund. The processing of numerous small payments would needlessly bog down the administration of the fund, and the costs of compliance would exceed the contribution amount. Ex. VZ-4 (Price Direct) at 18-19, 22.

²⁹⁷ Ex. ALECA-1 (Meredith Direct) at 9. ALECA also requests that ILECs be reimbursed for their contributions to the AUSF. The result would be that ALECA members alone would bear none of the burden of paying for their ambitious proposals.

Verizon explained above why the current AUSF should not be expanded at all, as ALECA wishes. It would add insult to injury to require new, innovative services to help fund a forty-fold increase in the size of the current fund. The Commission should not burden new services and technologies, and the customers that use them, with the obligation to finance the rural LECs' chosen business models. These service and technology innovations are spurring competition in the communications market, and providing an impetus for reduced rates in the traditional wireline sector. If the Commission chooses to force wireless and VoIP providers to contribute to an expanded AUSF, the result will simply be higher rates, the chilling of innovation, reduced investment in Arizona, and fewer competitive options and fewer benefits for consumers.²⁹⁸ Accordingly, the Commission should not hamper the continued growth of wireless and VoIP by imposing new fees on the customers of those services.

Wireless service providers do not currently pay intrastate switched access charges, except on a small portion of traffic in Arizona.²⁹⁹ Calls within wireless service areas, known as Major Trading Areas ("MTAs"), are considered local traffic, for which switched access charges do not apply. If a wireless call originates in one MTA but terminates to a LEC end user in a different MTA, the "interMTA" call would be subject to access charges. Because the vast majority of Arizona calling is within a single MTA, most wireless traffic is not subject to access charges.³⁰⁰

It would therefore be highly inequitable to force wireless providers to begin subsidizing access services that they do not use. Wireless carriers will not receive any

²⁹⁸ Ex. VZ-2 (Price Reply) at 23-24.

²⁹⁹ Ex. AT&T-1 (Aron Direct) at 40-44; Ex. VZ-2 (Price Reply) at 24-25.

³⁰⁰ Similarly, it is unsettled whether VoIP services are currently subject to intrastate switched access charges. See Ex. AT&T-1 (Aron Direct) at 46-47.

benefit from ILEC access charge reductions, so there is no factual, logical or other basis for requiring them to finance those access reductions through substantial contributions to an expanded AUSF. A mere desire to “spread the pain” is not sufficient reason to impose significant new burdens on these other service providers. Significantly, ALECA did not provide any justification for this radical change.

Verizon’s witness also explained that a decision to require wireless carriers to pay into an expanded AUSF program in order to replace the ALECA members’ foregone access revenues “would circumvent and conflict with the agreed terms and intent of the parties’ negotiated and Commission-approved interconnection agreements” that specify the rates (if any) that apply to intraMTA and interMTA wireless traffic in Arizona.³⁰¹ It is legally doubtful that the Commission could abrogate these existing contractual rights by revising the AUSF as suggested by ALECA and imposing new charges on wireless carriers.

For all these reasons, expanding the AUSF in the manner proposed by ALECA would be contrary to sound public policy and would not be competitively neutral for service providers in the market.

VIII. CONCLUSION

For the foregoing reasons, the Commission should immediately cap the intrastate access rates of CLECs at the level of Qwest’s intrastate rates. The Commission should establish the same price standard for rural LECs, and require all ILECs in Arizona to reduce their intrastate access rates to that level in the manner described above.

³⁰¹ Ex. VZ-2 (Price Reply) at 25-26.

RESPECTFULLY SUBMITTED this 9th day of July, 2010.

LEWIS AND ROCA

A handwritten signature in black ink, appearing to read "Michael T. Hallam", written over a horizontal line.

Thomas H. Campbell
Michael T. Hallam
40 N. Central Avenue
Phoenix, Arizona 85004

Attorneys for Verizon